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IN THE

Supreme Court of the United States

OCTOBER TERM 1969

Nos. 914, 915, 916, 917, 920, 921, 1038 and 1057

THE NEW HAVEN INCLUSION CASES

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT BEFORE JUDGMENT

BRIEF FOR PETITIONER-APPELLANT-RESPONDENT MANUFACTURERS HANOVER TRUST COMPANY, As Trustee of the First and Refunding Mortgage of The New York, New Haven and Hartford Railroad Company

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Preliminary Statement

This consolidated proceeding involves appeals* from final orders of a Statutory Three Judge Court of the United

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* *The New York, New Haven & Hartford Railroad Company First Mortgage 4% Bondholders Committee* v. *United States, Interstate Commerce Commission, et al.* (No. 915); *Manufacturers Hanover Trust Co., as Trustee of the First and Refunding Mortgage of The New York, New Haven & Hartford Railroad Co.* v. *United States, Interstate Commerce Commission, et al.* (No. 917); and *Chase Manhattan Bank, N.A., as Trustee under the General Income Mortgage of the New York, New Haven & Hartford Railroad Co.* v. *United States, Interstate Commerce Commission, et al.* (No. 921).

States District Court for the Southern District of New York and writs of certiorari* to the United States Court of Appeals for the Second Circuit (before judgment in that Court) to review the orders of the United States District Court for the District of Connecticut (sitting as a Court for the Reorganization of a Railroad).** The orders involved relate to the terms and conditions of the sale of substantially all of the assets of The New York, New Haven and Hartford Railroad Company (the "New Haven") and of the New Haven's inclusion in Penn Central Company ("Penn Central").

Opinions Below

The Second Supplemental Report and Order of the Interstate Commerce Commission (the "Commission"), dated November 16, 1967 (the "Inclusion Report"), is reported at 331 I.C.C. 643 and is reprinted at pp. 1-111a of the Appendix of Decisions and Constitutional and Stat-

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* *The New York, New Haven & Hartford Railroad Co., First Mortgage 4% Bondholders Committee* v. *Richard J. Smith, as Trustee of the Property of New York, New Haven & Hartford Railroad Co., et al.* (No. 914); *Manufacturers Hanover Trust Co., as Trustee of the First and Refunding Mortgage of the Debtor* v. *United States, Interstate Commerce Commission and Penn Central Company, et al.* (No. 916); *Chase Manhattan Bank, N.A., as Trustee under the General Income Mortgage of The New York, New Haven & Hartford Railroad Co.* v. *Penn Central Company, et al.* (No. 920); *Penn Central Company* v. *Manufacturers Hanover Trust Company, as Trustee, et al.* (No. 1038); and *United States of America and Interstate Commerce Commission* v. *The New York, New Haven and Hartford Railroad Company 4% Bondholders Committee, et al.* (No. 1057).

** This Court granted certiorari in Nos. 914, 916, 920, 1038 and 1057, noted probable jurisdiction in Nos. 915, 917 and 921, and ordered these proceedings consolidated for argument, on an expedited schedule, by order dated February 2, 1970.

utory Provisions.* The opinion of the Statutory Three Judge Court for the Southern District of New York (the "Three Judge Court"), dated July 10, 1968, remanding the Inclusion Report, is reported at 289 F. Supp. 418 and is reprinted at App. 323-83a. The opinion of the Three Judge Court, dated August 5, 1968, denying reargument is not yet reported; it is reprinted at App. 384-86a. The opinion of the United States District Court for the District of Connecticut (the "Reorganization Court"), dated August 10, 1968, remanding the Inclusion Report, is reported at 289 F. Supp. 451 and reprinted at App. 237-60a.

The Commission's Fourth Supplemental Report and Order, dated November 25, 1968 (the "Remand Report"), is reported at 334 I.C.C. 25 and reprinted at App. 112-221a. The opinion of the Reorganization Court, dated May 28, 1969, reversing and remanding the Remand Report, is reported at 304 F. Supp. 793 and is reprinted at App. 277-306a. The opinion of the Three Judge Court, dated June 18, 1969, modifying the Remand Report and affirming it as modified, is reported at 305 F. Supp. 1049 and is reprinted at App. 400-43a. The Three Judge Court also field a "Memorandum on the Decree," dated September 11, 1969, which is not yet reported; it is reprinted at App. 444-46a.

In response to the Three Judge Court's opinion, dated June 18, 1969, the Commission issued a Fifth Supplemental Report, dated July 10, 1969, which, as modified by the Commission on August 26, 1969, is reported at 334 I.C.C. 528 and reprinted at App. 222-28a.

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* This Appendix was filed simultaneously with the filing of the Jurisdictional Statements and Petitions in Nos. 914, 915, 916, 917, 920 and 921; references to this Appendix will be identified hereafter by the abbreviation "App." preceding the page numbers, which are identified by the letter "a".

Jurisdiction

The decree of the Three Judge Court was entered September 11, 1969 (App. 446-52a). Notice of Appeal to this Court was filed by Appellant on October 9, 1969 (Rec. 10b).* The Jurisdictional Statement was filed on December 5, 1969 (Rec. 10b) and this Court noted probable jurisdiction on February 2, 1970 (Rec. 10b). Jurisdiction of this Court rests on 28 U.S.C. §1253.

The final order of the Reorganization Court was entered on July 28, 1969 (App. 316-22a). A Notice of Appeal to the Court of Appeals for the Second Circuit was filed by Appellant on August 26, 1969 (Rec. 9b) and the Record on Appeal was timely docketed in that Court on December 1, 1969 (Rec. 10b). The Petition for Certiorari was filed on December 5, 1969 (Rec. 10b) and was granted by this Court on February 2, 1970 (Rec. 10b). Jurisdiction of this Court rests on 28 U.S.C. §§1254(1) and 2101(e) and Rule 20 of the Rules of this Court.

Constitutional Provisions and Statutes Involved

The provisions of the United States Constitution and Statutes involved in this case are:

(1) The Fifth Amendment to the United States Constitution;

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* "Rec." refers to the Record Appendix, containing the chronological statement (identified by the letter "b" after the page reference) and excerpts from the record below (identified by the letter "c" after the page reference) which is being filed with this brief.

(2) The Interstate Commerce Act §§1(18), 1(20), and 5(2), 49 U.S.C. §§1(18), 1(20) and 5(2); and

(3) The Bankruptcy Act §§77(b), 77(d), 77(e), 11 U.S.C. §§205(b), 205(d) and 205(e).

These provisions are reprinted beginning at App. 453a.

Questions Presented

1. Whether an insolvent railroad which has been required to continue in operation for over seven years at substantial loss and consequent erosion of the security of its bondholders, may be required under the United States Constitution, Section 5(2) of the Interstate Commerce Act, and Section 77 of the Bankruptcy Act, to accept consideration worth substantially less than the fair liquidation value of the assets being sold, including specifically the following questions:

(a) Whether it is constitutionally permissible and in accordance with the requirements of Section 5(2) of the Interstate Commerce Act and Section 77 of the Bankruptcy Act for the Commission to reduce the net liquidation value of the New Haven assets being sold by an allowance of $15.4 million for the assumed consequences of a hypothetical delay in the commencement of liquidation caused by the fact that the Commission and the courts might postpone abandonment for a further period of one year beyond the valuation date selected by the Commission, where the railroad has been operating at a loss in reorganization, and at the expense of its bondholders, for more than seven years;

(b) Whether it is constitutionally permissible and in accordance with the requirements of Section 5(2) of the

Interstate Commerce Act and Section 77 of the Bankruptcy Act for the Commission to make a further reduction of $6.7 million in what it has found to be the net liquidation value of the railroad in order to give Penn Central the equivalent of an entrepreneur's profit or compensation for an entrepreneur's assumed risk on the theory that the assets of the New Haven are to be sold "in bulk";

(c) Whether it is constitutionally permissible and in accordance with the requirements of Section 5(2) of the Interstate Commerce Act and Section 77 of the Bankruptcy Act for the Commission to treat as valueless, in determining the liquidation value of the railroad, the right of the railroad to fully-paid access to Grand Central Terminal and its related right to the income formerly used to defray Terminal expenses;

(d) Whether it is constitutionally permissible and in accordance with Section 5(2) of the Interstate Commerce Act and Section 77 of the Bankruptcy Act for the Commission to achieve a purported equality between what it has found to be the adjusted liquidation value of the assets conveyed by the New Haven and the value of the consideration to be received by the New Haven by assigning grossly inflated values to the Penn Central stock received by the New Haven as partial consideration for the sale, and whether the modifications made by the Reorganization Court and adopted by the Three Judge Court are adequate to cure this deficiency;

(e) Whether it is constitutionally permissible and in accordance with the requirements of Section 5(2) of the Interstate Commerce Act and Section 77 of the Bankruptcy Act for the Commission to find, on the basis of matters dehors the record, that one appraisal of certain real estate owned by the New Haven, namely the Harlem River and Oak Point Yards, is correct and other appraisals are incorrect, and

whether the valuation of this property adopted by the Commission is supported by substantial evidence on the whole record;

(f) Whether it is constitutionally permissible and in accordance with the requirements of Section 5(2) of the Interstate Commerce Act and Section 77 of the Bankruptcy Act for the Commission, in spite of evidence from both sides that its calculations are erroneous, to refuse on remand to consider and decide the proper amount of the discount necessary to determine the present value of the net receipts of liquidation which are assumed to be received over a period of time; and

(g) Whether it is constitutionally permissible and in accordance with the requirements of Section 5(2) of the Interstate Commerce Act and Section 77 of the Bankruptcy Act for the Commission to disregard the "going concern" value of the railroad as a utility in being which is to be continued in operation where this is an element of value which must be compensated for under state law.

2. Whether, in view of the terms and conditions of the orders of this Court and of the Commission approving the merger of Penn and Central, the Commission, under the Constitution, Section 5(2) of the Interstate Commerce Act, and Section 77 of the Bankruptcy Act, may properly require the bondholders of the New Haven to absorb the New Haven's operating losses during the eleven-month period between the Penn Central merger and the inclusion of the New Haven in the merged railroad.

Statement of Facts

Background

Proceedings for the reorganization of the New Haven under Section 77 of the Bankruptcy Act were initiated by petition of the New Haven dated July 7, 1961 and filed in the Reorganization Court and with the Commission in Finance Docket No. 21669.

Toward the end of 1961 the New Haven Trustees approached both Penn and Central looking toward the acquisition of the New Haven by one or the other of the roads individually. At that time Penn and Central had not agreed upon a merger. The New Haven Trustees were told by each of the roads that they were not interested in acquiring the New Haven (NHI-1, p. 9, filed in Document No. 118 of the Three Judge Court record). In their first report to the Reorganization Court, in March 1962, the New Haven Trustees stated that due to the nature of its operations as a predominantly terminating carrier, the New Haven could not be made viable as an independent railroad and that the only hope of preserving its operations was for the New Haven to become part of a trunkline railroad.*

On March 9, 1962, Penn and Central filed a petition with the Commission, under Section 5(2) of the Interstate Commerce Act, for approval of their merger. With leave of the Reorganization Court, the New Haven Trustees thereupon, on June 26, 1962, intervened in the merger case to seek inclusion of the New Haven in the merged Penn Central. In June of 1964 there was an indication in a brief filed with the Commission that under appropriate circum-

* The New Haven had operated at a deficit since 1956, and has continually incurred substantial deficits in both net railway operating income and net income before and since it went into reorganization.

stances Penn Central might be willing to lease the freight operations of the New Haven. The first meeting of the New Haven Trustees with Penn and Central resulted on June 16, 1964.

Negotiation of the Inclusion Agreement

Actual bargaining between the New Haven Trustees and Messrs. Perlman and Saunders, on behalf of Penn and Central, for the sale of the New Haven assets took place at four meetings, one on June 16, 1964, the second on July 1, 1964, the third on September 30, 1964 and the final meeting on November 9, 1964, at which the basic consideration was agreed upon. Both sides negotiated on a book, or asset value basis. (Rec. 19-20c; NHI-65, p. 16, in Document No. 120 of the Three Judge Court record).

At the November 9 meeting, Penn Central made an offer to pay the estate $52,000,000, in the form of 635,000 shares of stock and $26,150,000 in bonds (Rec. 19c); the New Haven Trustees asked for 865,000 shares, $20,000,000 in cash and $20,000,000 in bonds (Rec. 19-21c). The then market value of the assets to be received under this proposal was approximately $75.5 million (Rec. 20-21c). Penn Central responded to this proposal with its so-called "top offer" —950,000 shares of stock, $23,000,000 in bonds and $8,000,000 in cash (having a then market value of about $70 million) and the Trustees accepted this proposal (Rec. 19-21c). Thus, the basic consideration to be paid to the New Haven was bargained out and agreed upon at a single meeting (*Id*).*

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* At oral argument before the Commission in the summer of 1967, the New Haven Trustees' counsel conceded: ". . . [T]he trustees will say to you that if they are wrong in their view of the Grand Central, then . . . their settlement with Penn-Central is wrong because we don't in that settlement get any share of that $227 million. We are settling it for a relatively modest amount" (Rec. 236c). The "Grand Central" referred to in that remark

The basic terms of sale were incorporated in a memorandum of agreement dated December 22, 1964 (NHI-17)* and executed, as revised, on or about February 5, 1965. The sale was to take place at an unspecified date after the merger of Penn and Central. Neither the terms of the Agreement nor the course of the negotiations were disclosed to the New Haven creditors until after the Commission's Trial Examiners, on March 29, 1965, made public a recommended decision approving the Penn Central merger and requiring inclusion of the New Haven freight operations as a condition of the merger. During the next year, the parties negotiated a definitive purchase agreement based on the sale of the operating assets and the freight, but not the passenger operations. This agreement was executed on April 21, 1966. It provides for the following consideration to be paid by Penn Central:

(a) 950,000 shares of the common stock of Penn Central;

(b) $23,000,000 in 5% bonds;

(c) $8,000,000 in cash;

(d) Certain assumptions of liability with respect to equipment obligations, leases, employee protection and pension costs; and

(e) Certain closing adjustments.

The New Haven Trustees obligated themselves to support the Penn Central merger and the terms of sale. (At that

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is what we will refer to in this brief as "The Grand Central Terminal Properties," viz., the parcel of land about two blocks wide generally running north along Park Avenue in Manhattan from the Grand Central Terminal itself (at 42nd Street) to about 57th Street, together with the improvements on that parcel, notably five hotels, the Terminal itself and a number of office buildings, the bulk of them on long-term ground leases.

* Filed in Document No. 118 of the Three Judge Court record.

time, the market value of the stock, bonds and cash was approximately $96,550,000).*

In April 1966, just after execution of the Purchase Agreement, the Commission made public a decision approving the merger of Penn and Central (327 I.C.C. 475), and, in a simultaneously released order, denied the New Haven's application to terminate all interstate passenger service, which had been filed in March, 1965 (327 I.C.C. 553). The Commission required Penn Central to include the passenger operations of the New Haven as well as its freight operations, all "upon such fair and equitable terms as the parties may agree subject to the approval of the Bankruptcy Court and the Commission."** The order

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* The agreement among Penn, Central and the New Haven Trustees, which was thereafter amended on several occasions to conform to decisions of the Commission, is referred to as the "Purchase Agreement."

** This requirement was incorporated in so-called "Condition 8" which reads in pertinent part as follows:

> "8. The Pennsylvania New York Central Transportation Company shall be required to include in the transaction all the New York, New Haven and Hartford Railroad Company —the inclusion of passenger operations being subject to the findings and determinations of the Commission as set forth in Finance Docket No. 23831 issued simultaneously with this report—upon such fair and equitable terms as the parties may agree subject to the approval of the Bankruptcy Court and the Commission. Within 6 months after the date this report is served, the parties shall file with the Commission for its approval, a plan for such inclusion. In the event the parties are unable to reach an agreement (and subject to approval by the Bankruptcy Court) such inclusion shall be upon such fair and equitable terms and conditions as the Commission may impose.
>
> • • • • •
>
> Jurisdiction is hereby reserved for such purposes. Consummation of the merger by applicants shall indicate their full and complete assent to these requirements." (327 I.C.C. at 553)

This Court ruled that Penn Central accepted this, and other conditions, by its act of merger. *Penn-Central Merger Cases*, 389 U.S. 486, 510 (1968).

further provided that "In the event the parties are unable to reach an agreement (and subject to approval by the Bankruptcy Court) such inclusion shall be upon such fair and equitable terms and conditions as the Commission may impose."

Thereafter, the New Haven Trustees and Penn Central amended the Purchase Agreement so as to eliminate the provision that Penn Central would not be required to operate any passenger service; there was no change in the consideration Penn Central was to pay.

The Initial Proceedings before the Commission

On October 27, 1966, the Trustees and Penn Central filed the Purchase Agreement with the Commission as the "'First Step" of a plan of reorganization. Hearings before a Commission Examiner commenced on January 16, 1967 and continued, with certain adjournments, through May 12, 1967; the Examiner's recommended report was dispensed with and and the case was submitted directly to the Commission on briefs and oral argument.

While the Commission proceedings were pending, the Bondholders Committee, by cross-petition dated April 26, 1967 and filed in the Reorganization Court, sought termination of the reorganization proceedings to permit the orderly liquidation of the New Haven. The Reorganization Court dismissed the cross-petition on February 13, 1968. *In re New York, N.H. & H.R.R.*, 281 F. Supp 65 (D. Conn. 1968) (App. 229a). The Bondholders Committee appealed.

In connection with its consideration of the New Haven Trustees' petition and the cross-petition of the Bondholders Committee, the Reorganization Court on July 11, 1967, requested the Commission to require inclusion by lease of the operations of the New Haven in Penn Central

simultaneously with consummation of the Penn Central merger. The Commission on August 1, 1967 ordered the Trustees and Penn Central to file within 30 days an agreement providing for operation of the New Haven by lease, or, absent such agreement, to file respective proposals for terms of a lease.

Instead, Penn Central filed on September 1, 1967 a proposal to lend to the New Haven $25 million over a period of three years. The Trustees filed on this date a separate proposal for a loan arrangement plus an arrangement for Penn Central's assumption, as an addition to the purchase price, of operating losses of the New Haven incurred from the time of the merger until the sale of the New Haven.

The Commission on September 12, 1967 ordered hearings to commence on September 25 before an Examiner on the question of an "appropriate arrangement" for support of New Haven operations. These hearings formed the basis of the interim relief section of the Commission's Inclusion Report.

The Inclusion Report

The Commission issued its Inclusion Report on November 16, 1967. In this decision the Commission, using a valuation date of December 31, 1966, apparently found that the net liquidation value of the assets of the New Haven which were to be sold under the Purchase Agreement was $128.9 million, which it "rounded off" to $125 million.* The Commission further found that the fair value of the consideration to be paid by Penn Central, as specified in the Purchase Agreement and including as its

* This figure included an allowance of $13 million for the New Haven's interest in the Grand Central Terminal Properties.

predominant part the 950,000 shares of Penn Central common stock, was $123.6 million, which it "rounded off" to $125 million.* Since it discerned an equality between the liquidation value of the assets to be transferred and the consideration to be paid, the Commission held that the terms of the Purchase Agreement satisfied the statutory standards.

Responding to the problem of "interim" relief in order to preserve the operations of the New Haven during the period between the merger of Penn and Central and inclusion of the New Haven, the Commission ordered Penn Central, upon its merger, to lend the New Haven up to $25 million and, upon inclusion, to reimburse the New Haven for up to a maximum of $5.5 million per year of its operating losses, computed under a formula. In order to discourage prolonged litigation by the bondholders, the Commission further limited the sharing of losses by providing that Penn Central would bear only 50% of the New Haven's formula losses in the second year after the merger, 25% in the third and none thereafter. Except for this "loan-loss" adjustment, the Commission approved the terms of the Purchase Agreement without change as "Step I" of the Plan of Reorganization and held that it satisfied the obligation of Penn Central upon the merger under Section 77 of the Bankruptcy Act, Section 5(2) of the Interstate Commerce Act and Condition 8 of the Commission's order.

The Initial Review by the Courts

In January, 1968, the present Appellants (and other bondholders) petitioned for review of the Inclusion Report and a Statutory Three Judge Court of the Southern

* The market value of this consideration at the time of the Commission's decision was approximately $83,250,000.

District of New York was convened.* The Three Judge Court, by opinion and order filed May 6, 1968 (289 F. Supp. 418, App. 323a), disapproved the Commission's Report on the ground that it appeared that Penn Central should be required to pay the New Haven an additional $45-50 million (289 F. Supp. at 440, App. 358a).**

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* The decision of the Statutory District Court sustaining the parallel review proceedings is reprinted at 289 F. Supp. 418, 424 fn. 3, App. 325a.

** In his subsequent dissent, Judge Weinfeld enumerated the deficiencies which the Three Judge Court found in the Commission's Inclusion Report, in the following terms:

"(1) the Commission's failure to discount New Haven's liquidation expenses over the projected six-year liquidation period, 289 F. Supp. at 427-28;

(2) its miscalculation of New Haven's right to surplus income from the Grand Central Terminal properties, *id.* at 428-33;

(3) its ambiguous valuation of the Harlem River and Oak Point freight yards, *id.* at 433-34;

(4) its erroneous valuation of New Haven's interest in the Boston & Providence Railroad, *id.* at 434-35;

(5) its failure to discount the 5% bonds with which Penn Central was to meet its obligations under the Purchase Price Adjustments, *id.* at 437-38;

(6) its error in deducting from the amount to be paid to New Haven the sum of outstanding real estate tax liens, *id.* at 438;

(7) its failure to indicate the source of its estimate of 1966 depreciation of New Haven properties, set forth in its brief before us but not in its Inclusion Report, *id.* at 438;

(8) its miscalculation of the cost to Penn Central of Penn Central's 5% bonds, its assumption of New Haven's obligations under the Boston & Providence mortgage, and its payment under the Purchase Price Adjustments, *id.* at 439;

(9) the Commission's failure to take into account a reduction in 1966 New Haven equipment obligations, *id.* at 439 n. 15;

(10) its conclusion that Penn Central would assume overmortgaged New Haven equipment, *id.* at 439;

On March 29, 1968, while the proceedings were pending before the Three Judge Court, the Commission certified the Purchase Agreement, as modified by the Inclusion Report, to the Reorganization Court as "Step I" of the Plan of Reorganization of the New Haven, pursuant to Section 77 (d) and (e) of the Bankruptcy Act. On April 8, 1968, the Reorganization Court appointed the Honorable John Van Voorhis, a retired Judge of the Court of Appeals of the State of New York, as Special Master "to hear and report respecting the right, title and interest [of the New Haven] in the Grand Central Terminal Properties." Judge Van Voorhis held hearings and took evidence on this point and, on June 18, 1968 and July 22, 1968, filed a report (Rec. 253-92c) and a supplemental report (Rec. 293-322c). The Reorganization Court thereupon heard final argument on the Plan.

By opinion and order dated August 13, 1968 (289 F. Supp. 451, App. 237a), the Reorganization Court disapproved the Plan, stating that, in its view, the additional consideration to be paid by Penn Central "might properly fall within a range of $33,000,000 to $55,000,000." It also held that continuation of the New Haven's deficit operations past December 31, 1968 would constitute an unconstitutional taking of the New Haven's property (289 F.

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(11) its failure to include any of Penn Central's absorption of New Haven's interim operating losses in the category of the cost of acquisition to Penn Central, *id.* at 440;

(12) its use of a sliding-scale formula for Penn Central's interim loss-sharing as a device to curtail litigation by the New Haven bondholders, *id.* at 444; and

(13) its tendency to "round off" sums, with a consequent loss of some $5.3 million to the New Haven estate, *id.* at 427." (App. 432-33a)

Supp. at 459, App. 245a). Both courts remanded the case to the Commission.*

Proceedings before the Commission on Remand; the Remand Report

The Commission conducted hearings on an expedited schedule in October, 1968. Oral argument and a recommended report were dispensed with and, on December 2, 1968, the Commission issued its Remand Report, dated November 25, 1968 (334 I.C.C. 25, App. 112a).

In its Remand Report, the Commission in essence addressed itself to criticisms of its Inclusion Report which were contained in the decisions of the courts and modified its earlier decision in several respects. Briefly, the effect of the Commission's decision was to increase the "net liquidation value" of the New Haven assets being sold by $33.8 million, from the $128.9 million figure which it had

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* Both reviewing courts sustained the results reached by the Commission in a number of respects as to which the bondholders had sought review. Thus, the courts sustained the Commission on the following points: (1) its rejection of the bondholders' contention that, as joint venturers and "partners" with Central in the development of the Grand Central Terminal Properties, they were entitled to at least a 41% share, based on historic car use, of the capital value of those properties, which were appraised at $227 million; (2) its rejection of the bondholders' contention that the "going concern" value of the New Haven, which their evidence showed was worth $55 million, and which the Commission had found in effect was worth $5.5 million, was an element of value in addition to liquidation value; (3) its rejection of the bondholders' contention that Penn Central should be required to bear all of the New Haven's operating losses for the period between the merger and inclusion of the New Haven; (4) its rejection of the bondholders' contention that the reduction in liquidation value on account of liquidation expenses and a write-off of over $8 million in fair market value for "distress sales" in the final years of liquidation were grossly excessive; and (5) its rejection of the bondholders' argument that its valuation of the consideration to be paid by Penn Central, particularly for the Penn Central stock, was grossly excessive.

developed in the Inclusion Report to $162.7 million (334 I.C.C. at 53, App. 140a).* But the Commission did not adopt this value. Rather, allegedly responding to the invitation of the reviewing courts to explicate a new theory of valuation, the Commission then introduced two new deductions from net liquidation value, described as "other pricing considerations" (334 I.C.C. at 53-63, App. 140-50a), one, of $15,386,000, for the assumed effect of a one-year delay before the beginning of liquidation (334 I.C.C. at 60, App. 147a) and the second, of $6,695,000, for a "bulk sale discount." The "bulk sale discount" was based on the premise that liquidation would necessarily occur on a bulk rather than a piecemeal basis, in which event, an entrepreneur who purchased the land in bulk for resale would be entitled to additional compensation beyond that taken into account by the appraisal witnesses** (334 I.C.C. at 62, App. 149a).

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* The Commmission eliminated all but $1.6 million of the duplication of real estate taxes (an increase of $14.6 million); increased its valuation of the New Haven's interest in the Grand Central Terminal Properties from $13 million to $28.9 million (an increase of $15.9 million); allowed $3.8 million as the discount to present worth of the liquidation expenses (an increase of $3.8 million); and increased its valuation of the New Haven's interest in the B&P from $4.7 million to $7.3 million (an increase of $2.6 million), but introduced a new reduction, for 1966 depreciation, of $3 million. (*Cf.* 334 I.C.C. at 53, App. 140a)

** The witness who proffered this theory had never seen any of the appraisals or read any of the appraisers' testimony (Rec. 461-62c, 476c, 477-79c). The basic valuation studies were put into evidence through the following witnesses: for the New Haven Trustees, by William Gordon, of Coverdale & Colpitts, Consulting Engineers; Frank A. Mason, Vice President of Meredith & Grew, Inc., appraisers; and Bradford Thompson, who headed the New Haven real estate department; for Penn Central, by Francis Gasparini, Central's General Real Estate Manager; Norman Hull, Central's Assistant Comptroller; and John R. White, Executive Vice President of James D. Landauer Associates Inc., real estate consultants; and for the bondholders, by Paul O'Keefe, a real estate appraiser.

These reductions, totaling $22,081,000, produced a valuation for the assets being sold of $140.6 million, or approximately $11.7 million more than the net liquidation value of $128.9 million developed by the Commission in its earlier report, before "rounding off."* To the $140.6 million figure the Commission added a $5 million lump sum "loss-sharing" allowance (334 I.C.C. at 68, 69, App. 155-56a),** giving a total figure to be paid by Penn Central of $145.6 million (334 I.C.C. at 71, App. 158a).

On the purchaser's side, the Commission found that this "price" would be met in the following manner:

Item	*I.C.C. Valuation (000,000)*
950,000 shares of Penn Central stock	$ 83.1
$31.5 million of Penn Central 5% bonds	27.4
Cash	8.0
Assumption of Harlem River Division Bonds	8.9
B&P Bonds	2.4
Purchase Price adjustments	15.8
	$145.6

In sum, the Commission, in its Remand Report, adjusted the consideration which it had approved in the Inclusion Report, by an additional $8.5 million of Penn Central 5% bonds (valued by the Commission at $7.6 million) and assumption of the 4% Harlem River bonds (valued by the Commission at $8.9 million), a total of $16.5 million; this figure included a $5 million allowance on account of the

* It exceeds the "rounded off" net liquidation value of $125 million which the Commission used in its earlier Report (331 I.C.C. at 688, App. 46a) by $15.6 million.

** According to the Commission, actual New Haven losses under its formula would be approximately $8.2 million for 1968. (334 I.C.C. at 73, App. 160a)

"loss-sharing" formula which the Commission had not previously taken into account in adjusting the consideration to be paid. Thus, the net increase in the consideration to be paid for the New Haven assets, on the Commission's valuation, was $11.5 million.

The Commission adhered to its original position on certain issues which the reviewing courts had remanded. Specifically, it held that: (1) the New Haven's Harlem River and Oak Point Yards should be valued at $18.1 million, rather than at $22.65 million, $26 million or $32 million as suggested by other appraisals in the record, since, in the Commission's view, there would be no rail service to these yards if the New Haven were liquidated; (2) the discount of gross liquidation receipts at $17.6 million as determined in its Inclusion Report, was proper, although both the bondholders' witness and Penn Central's witness reached a lower result; and (3) the New Haven's right to fully-paid access to and use of Grand Central Terminal and its interest in the income formerly used to defray its proportionate share of Terminal expenses had no value in liquidation. While the Commission eliminated the *"in terrorem"* or "sliding-scale" limitation on Penn Central's share of interim losses, it nevertheless retained the other aspects of its loss-sharing formula and required the New Haven to bear all losses during the eleven-month period between the merger and inclusion of the New Haven in excess of $5,000,000. Although the Commission heard evidence on the fair value of the Penn Central shares, it adhered to its view that the value of the 950,000 Penn Central shares was $87.50 per share, or $83.1 million.*

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* The stock had a market value of 52⅜ on December 31, 1966, the valuation date used by the Commission for the New Haven assets, and a 60-65 market value during November, 1968, when the Commission was deliberating. The stock closed at 63⅜ on the actual closing date, December 31, 1968 and, since then, has steadily declined. On February 20, 1970, it closed at 26¼.

Responding to the determination of the Reorganization Court that the New Haven could not continue independent operation beyond January 1, 1969, the Commission ordered the transfer of the New Haven assets to Penn Central to take place by that date, irrespective of the pendency of any proceedings with respect to the value of the assets or the price to be paid.

The Second Review by the Courts

After the Commission certified the Plan of Reorganization which was embodied in its Remand Report to the Reorganization Court, on December 2, 1968, the Reorganization Court by order dated December 24, 1968 (App. 263-76a) approved and ordered the transfer, reserving the issues of price. The transfer took place on December 31, 1968, after Penn Central's application to the Three Judge Court for a stay was denied on December 27, 1968 (App. 387-93a).* In the arguments before both courts, Commission counsel stated that it was the position of the Commission that the possibility that any price which Penn Central might be ordered to pay as a result of any of the proceedings growing out of the Remand Report would exceed what the Commission would accept as "fair" to Penn Central was "theoretical." (Transcript of Oral Argument before the Reorganization Court, December 20, 1968, pp. 51-52.)

Prior to the closing of the sale of the New Haven assets, Manufacturers Hanover, on December 30, 1968, filed a petition for review of the Remand Report in the United States District Court for the Southern District of New

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* Penn Central did not appeal from the order of the Three Judge Court denying a stay; it did file a notice of appeal from the order of the Reorganization Court and that appeal was among the appeals which were consolidated by the order of the United States Court of Appeals, dated and entered October 7, 1969, as to which certiorari has been granted.

York which was subsequently consolidated with petitions of other bondholder representatives.

The Reorganization Court determined the price issues in its decision of May 28, 1969 (304 F. Supp. 703, App. 277-306a) and entered its order determining those issues on July 28, 1969 (App. 316-19a). The Three Judge Court decided the price issues in its opinion dated June 18, 1969 (App. 400-43a) and entered its decree thereon on September 11, 1969 (App. 446-52a). The decisions of the two reviewing Courts are in conflict on matters having a total value of about $29 million, specifically the following:

Items which Reduce Liquidation Value	*Reorganization Court*	*The Majority of the Three Judge Court**
"Administrative Delay" Discount—$15,386,000	Rejected (App. 279-92a)	Approved (App. 411-16a)
"Bulk Sale" Discount—$6,695,000	Rejected (App. 292-94a)	Approved (App. 416-18a)
Items which Increase Liquidation Value		
Adjustments in the valuation of the Harlem River and Oak Point Yards—$4,439,000	Approved (App. 295-97a)	Rejected (App. 423a)
Adjustments in the discount to present worth of net liquidation receipts	Approved an increase of $2,415,889 (App. 318a)	Tentatively approved an increase of $410,000 pending review by this Court (App. 444-45a)

* Judge Weinfeld in dissent agreed with the Reorganization Court, and disagreed with the majority of the Three Judge Court, with respect to the "administrative delay" (App. 435-38a) and "bulk sale" discounts (App. 438-39a) and the valuation of the Oak Point and Harlem River Yards (App. 442-43a). He apparently expressed no view on the question of the discount of net receipts to present value.

Both courts agreed that the Commission erred in valuing the Penn Central stock at $87.50 per share or, in total, at $83.1 million. Under a formula developed by the Reorganization Court and subsequently adopted in substance by the Three Judge Court (and accepted by the Commission), both courts required, in essence, that Penn Central underwrite the difference between the market value of the shares at February 1, 1978 and $83.1 million. Judge Weinfeld in dissent would not subscribe to this plan; he insisted that the New Haven was presently entitled to the cash equivalent of the estimated value of stock transferred, or $83.1 million (App. 441a).*

Both courts rejected the bondholders' argument that liquidation value should be increased to properly account for several items which the Commission had either rejected or, in their view, undervalued: (1) the New Haven's right to fully-paid access to and use of Grand Central Terminal; (2) the New Haven's going concern value; and (3) the New Haven's operating losses between merger and inclusion.

Summary of Argument

Because of the unusual jurisdictional framework in which this case has arisen, this Court is presented with decisions of two courts of coordinate jurisdiction, which have reached inconsistent results in several substantial respects.

I. In agreement with the Reorganization Court, and contrary to the majority of the Three Judge Court, we submit that the decision of the Commission setting the terms of the sale of the New Haven to Penn Central violated the constitutional rights of the New Haven creditors

* Judge Weinfeld also disagreed with the other judges on the loss-sharing question; he would have held that Penn Central should bear all interim operating losses (App. 442a).

to at least the net liquidation value of the New Haven assets, established in decisions of this Court such as *Brooks-Scanlon Co.* v. *Railroad Commission,* 251 U.S. 396 (1920), and also violated the statutory standard of fairness and equity embodied in Section 5(2) of the Interstate Commerce Act and Section 77(b) of the Bankruptcy Act. By rejecting net liquidation value as the standard of valuation, and modifying that standard by introducing reductions premised upon the asserted power of the Commission to limit the right to abandon, the Commission imposed upon this hopelessly insolvent railroad a duplication of losses which neither due process requirements nor the statutory scheme permits even in the public interest. The attempt of the Three Judge Court majority to sustain the Commission's adjustments in the liquidation value standard involves reasoning of the sort condemned by this Court in *SEC* v. *Chenery,* 318 U.S. 80, 94 (1943). Moreover, neither the findings of the Commission nor the reasoning of the Three Judge Court majority are supported by substantial evidence.

II. In agreement with the Reorganization Court, and in disagreement with the majority of the Three Judge Court, we contend that two specific determinations of the Commission with respect to the valuation of the New Haven assets, namely, its valuation of the Oak Point and Harlem River Yards and the computation of the proper discount to present worth of the net liquidation proceeds, are not supported by substantial evidence and, in fact, are contrary to the evidence. We further contend, with respect to the valuation of the Harlem River and Oak Point Yards, that the Commission violated the standards of procedural due process and denied Appellant a fair hearing by resting its decisions upon matters outside the record, as to which Appellant had neither notice nor an opportunity to be heard.

In addition to the foregoing matters on which the reviewing courts reached conflicting decisions, there are several issues of valuation on which, we submit, the results reached by both courts are in error and have reached results which are either erroneous as a matter of law or are not supported by substantial evidence. Specifically, we raise the following points:

(a) In valuing the New Haven's partnership interest in the Grand Central Terminal Properties, the Commission only awarded the capitalized value of the so-called "excess income". While both the Commission and the courts apparently recognized that the New Haven's right to have a portion of Terminal revenue—about $5.6 million per year—applied to its share of Terminal expenses was a valuable asset, they concluded that this right would be valueless in liquidation because there was no one to buy it. In so holding, the Commission and the courts disregarded the fact that the New Haven had at least two purchasers—namely, Penn Central itself, which actually acquired the right on January 1, 1969, and the States which have been bargaining for several years to acquire the New Haven commuter service and will, in the event of a sale, be required to compensate Penn Central for the use of the Terminal which, like the Terminal income, it now owns outright.

(b) While both reviewing courts rejected as too high the Commission's valuation of 950,116 shares of Penn Central stock, the "underwriting formula" they adopted to meet this deficiency is inadequate. The reviewing courts have failed to fully remedy the gross imbalance between the value of the assets sold and the value of the consideration to be received, although both the Commission and the reviewing courts have recognized that equivalence between the value of the assets and the value of the consideration is the valuation standard which is applicable in this case.

In order to bring about this equivalence, in terms of the stock portion of the consideration, it is necessary to substantially increase the amount of the consideration, either by additional shares or by other means. The terms of the "underwriting formula" should likewise be modified in several respects.

(c) Since the New Haven was taken over in the public interest as a going concern, and was intended to be continued in operation, the New Haven was entitled, at least under the condemnation law of New York where a substantial part of its assets are located, to a substantial award for its "going concern" value in addition to the "scrap" or liquidation value of its assets.

(d) The Commission erred as a matter of law, and deprived the New Haven estate of its property without due process by failing to require Penn Central to pay all of the operating losses of the New Haven, rather than a relatively minor portion, during the eleven-month period of delay between Penn Central's merger and its acquisition of the New Haven, during which the New Haven was forced to incur heavy operating losses in the public interest in order to be available for inclusion. Since the delay in the inclusion of the New Haven was largely for the benefit of Penn Central, no improper burden would be imposed on Penn Central by requiring it to bear the losses which it would have incurred if the New Haven inclusion had taken place at the time of merger.

POINT I

In the Circumstances of This Case, the Commission Erred as a Matter of Law in Rejecting Net Liquidation Value as the Valuation Standard Under Section 5 of the Interstate Commerce Act and Section 77 of the Bankruptcy Act; the Error of Law Apart, the Commission's "Other Pricing Considerations" Were Not Supported by Substantial Evidence.

In its Inclusion Report, the Commission accepted the net liquidation value of the assets to be conveyed by the New Haven as the standard of valuation to determine fairness and equity under Section 5(2) of the Interstate Commerce Act and Section 77(e) of the Bankruptcy Act. The Commission found that the liquidation value was "about $125 million as of December 31, 1966" (331 I.C.C. at 688, App. 46a) and also valued the consideration at $125 million (331 I.C.C. at 692, App. 50a). Based on this apparent equivalence, the Commission found that the Purchase Agreement was fair and equitable (331 I.C.C. at 697, App. 55a).

Applying the same valuation standard, the reviewing courts found that the New Haven had been awarded from $33 and $55 million too little—and remanded the case for further proceedings. The Commission, after revising its valuations by approximately $33 million to meet some of the criticisms of the reviewing courts, rejected "net liquidation value" as the valuation standard for determining the fairness of the consideration (334 I.C.C. at 53-57, App. 140-44a). Instead, on the theory that it was "pricing out" reasonable limitations on the right to abandon (334 I.C.C. at 57, App. 144a), the Commission made two further reductions in net liquidation value—one of $15,386,000 for the

assumed effect of a one-year delay in liquidation past the valuation date until the New Haven could obtain leave of the Commission to abandon the line, and one of $6,695,000 to account for an alleged reduction attributable to a sale in bulk.

The Reorganization Court disapproved both adjustments and held that, contrary to the Commission's view, liquidation value is a constitutionally guaranteed minimum. With respect to the Commission's underlying theory, it commented:

> "The Commission's Fourth Supplemental Report and its counsel's express admission in oral argument before this court have made clear that the Commission neither developed nor applied a new or different pricing theory; but purported to base its determination on fair liquidation value. Its newly conceived deductions for delay in issuing an abandonment certificate and for a bulk sale discount are described by the Commission as 'refinements' of the fair liquidation value theory. It also disputed the courts' interpretation of the constitutional mandate and adopted one of its own. This appears to be that the use of the pricing theory based upon fair liquidation value wholly derives from, and is completely subject to, the issuance of an abandonment certificate by the Commission, which it will not issue to a debtor, as a matter of right, though the debtor has for many years been submerged in a deficit operation with no prospect of improvement, but may grant as a privilege in its sole discretion, to be given or withheld on the conclusory basis that its action is 'fair and equitable' and 'required by the public interest', and apparently unsupported by anything more substantial than the Commission's own

introspections or the latest word from the Cumean Sybil.

The Commission also asserts that, because the Constitution does not specify any particular method of valuation, it possesses unrestricted flexibility and range of discretion; and 'due process' and 'just compensation' referred to in the Fifth Amendment mean compensation based upon the value of the assets remaining after the debtor's estate has been invaded to the unlimited extent the Commission finds is called for by the paramount public interest, provided the Commission takes pains to declare it fair and equitable. This is tantamount to no constitutional protection whatever.

* * *

This court adheres to the position that due process and just compensation provisions of the Fifth Amendment prohibit the imposition of a further period of erosion of assets on the New Haven. It has ruled that any erosion additional to that accumulated through 1968 would be constitutionally impermissible as a taking without just compensation. But in its Fourth Supplemental Report the Commission asserts that the constitutional limitation sets up no standard of value and is very flexible, so that it leaves the Commission with an almost completely unrestricted discretion so long as it declares that its decision is fair and equitable and in the public interest. The Three Judge Court and this court rejected that legal principle in their former opinions, 289 F. Supp. 418 at 440-441 and 289 F. Supp. 451 at 459; and the law as established by these courts was the law of the case which the Commission should have followed." (304 F. Supp. at 799, 801, App. 281-82a, 285-86a)

Finally, it found that the Commission's adjustments were lacking in factual support.

The majority of the Three Judge Court also concluded, contrary to the Commission, that the New Haven was constitutionally entitled to liquidation value:

> "A more difficult question is whether the Fifth Amendment forbids application of the statute in such a manner as to produce a price less than liquidation value on the facts here presented. When the case was last before us, we indicated tentative agreement with that position. We cited authorities which established in our view that a railroad with no reasonable hope of future earnings, such as NH, had a "constitutional right . . . to cease operations and liquidate," 289 F. Supp. 440, since to force operation at a loss "would be to take its property without the just compensation which is a part of due process of law." Railroad Commission v. Eastern Texas R.R., 264 U.S. 79, 85 (1924); Bullock v. State of Florida ex rel. Railroad Commission, 254 U.S. 513 (1921); Brooks-Scanlon Co. v. Railroad Commission, 251 U.S. 396 (1920). Despite observations in the Commission's report, 334 I.C.C. at 55-57, we adhere to that view, for reasons fully developed in the recent opinion of the reorganization court, subject only to the qualification that liquidation of NH could not commence until the Commission, acting with appropriate speed under §1(18) of the Interstate Commerce Act, had issued the certificate of abandonment to which NH would have been constitutionally entitled. We believe this position is also supported by two opinions of Mr. Justice Brandeis which we read as declaring that while Congress may in the public interest subject a secured creditor to reasonable delays in realizing on his security, it may not deprive him

altogether of his right to sell the res at public auction. Louisville Joint Stock Bank v. Radford, 295 U.S. 555 (1935); Wright v. Mountain Trust Bank, 300 U.S. 440 (1937)." (App. 407-08a)

The court felt, however, that it could affirm the Commission's introduction of "other pricing considerations" as a "refinement" of liquidation value without passing on its underlying theory.* The dissenting judge, Judge Weinfeld, found the Commission's explication of the basis for its adjustments unsound and rejected the "adjustments" on the ground that the abandonment delay reduction "is without justification and is not based upon substantial evidence" (App. 438a), while the bulk sale adjustment is "an unwarranted duplication of part of the expense already charged to the New Haven." (App. 439a)

In spite of the Commission's contentions, the lower courts were plainly correct in holding, based upon controlling decisions of this Court, that there is a constitutional right to abandon and liquidate an inherently unprofitable railroad. *Railroad Commission* v. *Eastern Texas R.R.*, 264 U.S. 79 85 (1924); *Brooks-Scanlon Co.* v. *Railroad Commission*, 251 U.S. 396 (1920); *cf. Pacific Telephone & Telegraph Co.* v. *Tax Commission*, 297 U.S. 403, 413 (1936).

In *Brooks-Scanlon*, this Court held that where a railroad is operating at a deficit and has no hope of achieving profitability, the owners may abandon operations. This Court wrote: "A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business

* The majority opinion questioned whether the constitutional question was reached in view of its doubt that governmental compulsion was involved, but expressly refused to rest its decision on this sort of analysis, saying "the proper administration of Section 5(2)(d) may require at least a close approach to what . . . [the Bondholders] could have realized in an assumed liquidation. . . ." (App. 410a)

of carriage." (251 U.S. at 399). In *Eastern Texas*, this Court sustained the right of the owners to "discontinue operation and get what it can out of the property by dismantling the road. To compel it to go on at a loss and to give up the salvage value would be to take its property without the just compensation which is a part of due process of law." (264 U.S. at 85). The decision of this Court in *Colorado* v. *United States*, 271 U.S. 153 (1926), cited (at 334 I.C.C. 56, App. 143a) as authority for the proposition that *Eastern Texas* and *Brooks-Scanlon* have been overruled *sub silentio*, does nothing of the sort.* That case dealt with the discontinuance of a single intrastate branch of a railroad, not discontinuance of all of a railroad's operations. *Colorado* v. *United States* recognized that a railroad cannot be compelled to continue its operations where all of the operations, considered together, are unprofitable, as is the case here (271 U.S. at 161). It recognized, as did the earlier cases cited above, that such a doctrine would force the owners of the railroad to give up their property without the prospect of compensation. What this Court did in *Colorado* v. *United States* was to approve an I.C.C. decision that a railroad could discontinue an unprofitable intrastate branch, and the Court's discussion of the powers of the I.C.C. dealt only with the authority of the I.C.C. to decide matters affecting intrastate branches of railroads.

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* As the Reorganization Court noted (304 F. Supp. at 803, fn. 7, App. 306a, fn. 7), the Commission's contention that *Colorado* v. *United States* overruled *Eastern Texas* and *Brooks-Scanlon sub silentio* is contrary to the view it expressed in its opinion in *Tennessee Central Railway Co. Abandonment*, 333 I.C.C. 443, 452 (1968), in which it recognized the continued vitality of *Brooks-Scanlon*, and said:

> "It is well established that a carrier should not be required to continue in the business of carriage when its over-all operations are conducted at a system-wide deficit for a substantial period of time and where there is no reasonable prospect of the applicant's conducting those operations at a profit for the foreseeable future." [citing *Brooks-Scanlon*.]

As we shall discuss in some detail below, the Commission in developing "refinements" to net liquidation value, and the majority of the Three Judge Court, in affirming those "refinements", failed to observe both of the standards which this Court laid down in *Ecker* v. *Western Pacific R. Corp.*, 318 U.S. 448, 473 (1943), namely, that the Commission's valuation must be reached "with material evidence to support the conclusion" and "in accordance with legal standards."

A. The Commission Erred in Reducing Net Liquidation Value by $15,386,000, as an Adjustment for the Assumed Effect of a Hypothetical One Year Delay to Obtain Leave to Abandon.

As the first step in pricing out the consequences of its power to limit abandonment, the Commission deducted $15,386,000 on the theory that once the decision to abandon was made, at least a year would elapse before the New Haven obtained a certificate of abandonment under Section 1(18) of the Interstate Commerce Act (334 I.C.C. at 58-60, App. 145-47a). The Commission assumed that it was entitled to treat that one year delay as having commenced on December 31, 1966 and further assumed that during that one year, the New Haven could make no progress toward accomplishing its liquidation.*

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* In its initial decision, the Three Judge Court had noted, after referring to this Court's decisions in *Brooks-Scanlon, Eastern Texas,* and *Bullock* v. *State of Florida ex rel. Railroad Commission,* 254 U.S. 513 (1921):

> "We cannot accept the argument that all this was changed by the addition of §1(18), requiring the Commission's consent to abandonment, . . . or by the enactment of §77 of the Bankruptcy Act in 1933. These statutes were designed to assure orderly procedures and to afford methods that might avoid the ultimate solution; they were not intended to override constitutional guarantees, *cf. In re Third Avenue Transit Corp.*, 198 F.2d 703, 707 (2 Cir. 1952), and would not be effective if they had been." (289 F. Supp. at 441, App. 359-60a; footnote omitted).

On both factual and legal grounds, we submit, these twin assumptions by the Commission were error in the circumstances of this case. The Commission's position is contained in the following remarks:

> ". . . . [W]e cannot look back to what might have been in 1962 or 1963, and may now consider to what extent 'lengthy abandonment proceedings' would reduce the value of the estate. The three-judge court correctly stated that if the trustees had presented abandonment applications as an alternative to a sale to Penn Central, the Commission would almost certainly have deferred their consideration for a reasonable period while inclusion was being explored.
>
> *We are only required in this proceeding to consider the alternatives that are now available to the creditors, not what might have been available in 1962 or 1963.* As the three-judge court added, the creditors 'by investing in a railroad • • • subject themselves to such interim losses as are reasonably incident to working out the solution most consistent with the public interest.'" (334 I.C.C. at 58-59, App. 145-46a; Emphasis supplied.)

Both factually and legally, we submit, the Commission was required precisely to consider what alternatives would have been available to the New Haven once reorganization commenced, if it had not been for the fact that, in the public interest, the New Haven was required for at least five years to continue its hopelessly deficit operations until it was possible to work out a solution consistent with the public interest, namely, inclusion in Penn Central. Such an inquiry would have shown that, but for the prospect of inclusion and the public interest which was deemed to require that course, the New Haven would have gone into liquidation long before December 31, 1966. The conclusion that flows from this fact is that it is unreasonable and

grossly unfair to treat the December 31, 1966 valuation date as one on which, assuming the liquidation hypothesis, the New Haven would have applied for leave to abandon operations. The whole history of this proceeding demonstrates that such an application would have been made and granted long before 1966, if the public interest had not precluded that course so long as the merger was in the offing.

The New Haven went into reorganization on Jnly 7, 1961, after five years of operating losses. From the time reorganization commenced, it was recognized that there was little hope that the New Haven could be made viable as an independent freight and passenger railroad.

The New Haven Trustees made this point clear in their first report to the Reorganization Court, in early 1962 (*cf.* 289 F. Supp. at 456, App. 241a). In that Report, they laid out the alternatives which confronted the New Haven—either merger with a trunk line railroad or liquidation. The Reorganization Court noted in its opinion that "By about 1963 it became apparent that the inclusion of the New Haven in the Penn-Central merger was the only salvation for the New Haven as an operating railroad, . . ." (289 F. Supp. at 456, App. 242a).

It is clear that had there been no inclusion proceedings, liquidation would necessarily have begun, and probably ended, long before December of 1966. Absent the prospect of inclusion, the Reorganization Court was bound, because it recognized by 1963 that the New Haven's case was hopeless aside from inclusion, to have required prompt liquidation to protect the bondholders' security. *In re Third Avenue Transit Corp.*, 198 F.2d 703, 706-07 (2d Cir. 1952); *Bankers Trust Co.* v. *Gebhart*, 195 F.2d 238 (2d Cir. 1952); *cf., Louisville Joint Stock Bank* v. *Radford*, 295 U.S. 555 (1935); *Continental Illinois National Bank &*

Trust Co. v. *Chicago R.I. Pac. Ry.*, 294 U.S. 648 (1935). Moreover, again absent inclusion, if liquidation proceedings had begun then, these proceedings would have ended, even assuming a delay for abandonment, long before December of 1966. As Judge Weinfeld noted in his dissent,

> "[A]s Judge Anderson, the one most familiar with these proceedings since their inception, has so convincingly demonstrated, but for Penn Central's commitment to take over New Haven as an operating entity, and the universal understanding that such would be the case, abandonment proceedings would have begun and terminated well before the end of 1966. To suggest otherwise flies in the face of this record." (App. 436a)*

But the New Haven Trustees could not have abandoned railroad operations and liquidated the New Haven in 1963, or thereafter. Once inclusion proceedings began, the courts would not, in the public interest, have allowed the New Haven to abandon the proceedings and liquidate. "If the Trustees had presented abandonment applications as an alternative to sale," the Three Judge Court concluded, "the Commission would almost certainly have deferred this consideration for a reasonable period of time while inclusion was being explored." (289 F. Supp. at 444, App. 366a) The Commission conceded the accuracy of this remark in its Remand Report (334 I.C.C. at 59, App. 146a).

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* In its opinion, dated February 15, 1965, authorizing the New Haven Trustees to petition the Commission to discontinue interstate passenger service, the Reorganization Court commented:

> "... [N]o construction of due process will permit this court to require that the creditors of this estate witness the continuing erosion of their security without the slightest prospect of relief.
>
> * * * * *
>
> If this tax burden continues to grow and the Railroad is not otherwise relieved, the creditors will be compelled to move for liquidation of the New Haven and the Court will have no recourse but to order it." (Rec. 7c, 12c)

As the majority of the Three Judge Court acknowledged:

> "The bondholders say, with considerable force, that this known attitude of the Commission was the practical equivalent of the denial of an application for abandonment. . . ." (App. 410a)

In its decisions, dated on April 6, 1966, in the *Penn Central Merger Case* (327 I.C.C. at 524) and in *The New Haven Passenger Train Discontinuance Case* (327 I.C.C. at 151), the Commission made clear its own view that continuation of the New Haven service was "essential" and rejected the New Haven Trustees' application, filed in October, 1965, to discontinue interstate passenger service, except on a contract basis,* in view of its action directing inclusion of the New Haven in the merged Penn Central.

The Bondholders' Committee petitioned the Reorganization Court in March of 1967 for permission to terminate the reorganization proceedings and promptly liquidate; on February 13, 1968, the Reorganization Court denied the petition in view of the public interest (App. 229a).

Moreover, even apart from the legal obstacles which made any effort at abandonment an exercise in futility, there was a very real practical obstacle to such an application, at least after November 9, 1964. On that date, the New Haven Trustees agreed with Penn and Central upon a sale of the New Haven freight operations to Penn Cen-

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* The Trustees were obligated to bring such proceedings, at the expense of the estate, by the terms of their agreement with Penn Central. The application had the further advantage, to the estate, of dramatizing the fact that the public bodies involved, particularly the states of New York, Connecticut, Rhode Island and Massachusetts, were not providing adequate financial support for the New Haven's passenger operations. Had the application been granted, either interstate passenger service would have ceased or the states would have been forced to subsidize such service at realistic levels.

tral, as the result of negotiations which began in June, 1964; the memorandum of agreement was apparently completed in December 1964 and was executed in February 1965, although it was not made public until after the filing of the recommended report of the Hearing Examiners in the Penn Central merger case, on March 29, 1965. By their agreement, the New Haven Trustees bound themselves not to take any position contrary to that of Penn and Central.

Thus, the record is clear, we submit, that from a time not later than the end of 1964, the New Haven was, as a practical as well as a legal matter, locked into continuing railroad operations in order, in the public interest, that it could be preserved for inclusion in Penn Central, and placed in a situation where an application to abandon and liquidate would have been futile.

The conclusion seems inescapable that it was the public interest in continued operation of the New Haven—and the concern of the Reorganization Trustees, the Reorganization Court and the Commission for that interest—which required the New Haven to be kept going for a further five years, from 1964 through 1968, while enormous deficits accrued and the security of the bondholders was eaten up, although it was fully recognized that the case of the New Haven was hopeless.* It cannot be equitable to go back and impose the hypothetical cost of following the abandon-

* The majority of the Three Judge Court (App. 412a) pointed to the fact that, in the inclusion hearings in early 1967, the Bondholders introduced a study which showed that, based on 1964 and 1965 operations "normalized", it appeared that the New Haven could be operated profitably as a freight-only railroad once it had been modernized. The Commission rejected the Bondholders contentions in its Inclusion Report (331 I.C.C. at 687, App. 45a), as they had, in April, 1966, rejected the New Haven Trustees application to discontinue long-haul passenger service. We fail to see how, on this state of the record, such evidence, or the Bondholders' rejected contentions, bear on the issues here.

ment route which the very same public interest has foreclosed.

There is no basis for the suggestion in the majority opinion of the Three Judge Court that the bondholders had in some way waived their right to pursue abandonment because they did not move for such relief until the spring of 1967. As Judge Weinfeld points out and as we have reviewed above, such an application at any time after 1964, would have been, as it proved to be in 1967, an idle exercise (App. 435-36a).*

It is no answer, we submit, to suggest, as the majority of the Three Judge Court appears to have done (App. 411-12a), that in selecting December 31, 1966 as the valuation date, the Commission was at liberty to assume that that was the date of a decision to liquidate, once necessary consents were given, rather than the date that liquidation would actually have commenced. As we have shown, but for inclusion, the decision to liquidate would have taken place long before December 31, 1966; thus, if the Commission had meant to pick December 31, 1966 as the date the New Haven decided to liquidate and then commenced the necessary administrative proceedings, its choice would have been wholly unreasonable. Moreover, there is nothing in the evidence before the Commission or in the Inclusion Report, to provide any basis for thus characterizing the December 31, 1966 valuation date. As Judge Anderson

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* Any suggestion of waiver disregards two further points—(1) the principal responsibility for making such an application rested on the Reorganization Trustees, and they had been bound at least since the execution of the Memorandum of Agreement with Penn Central in February, 1965 to support inclusion in the Penn Central merger; and (2) the bondholders had the clearest assurances, at least as early as the decision of the Commission ordering inclusion of the New Haven in Penn Central, dated April 6, 1966, that upon inclusion they would receive the fair value of their property.

noted, "The historically recognized theory of fair liquidation value" envisions "a context where all the elements of a sale are present and only price [remains] to be fixed." (304 F. Supp. at 805, App. 292a) In its own previous abandonment decisions, the Commission had consistently recognized that while it had the power to require the abandoning railroad to sell its property in bulk to a purchaser who would continue railroad operations, such a requirement was conditioned upon the purchaser agreeing to pay the scrap value of the property to be sold. See, *e.g., Tennessee Central Ry. Co. Abandonment,* 331 I.C.C. 433, 454-55 (1968); *New York Central R.R. Co. Acquisition of Chicago, Attica & Southern R.R.,* 197 I.C.C. 527 (1932) and the other cases cited at p. 49 *infra.*

In both of its reports, the Commission used December 31, 1966 as the valuation date, because that was the most recent date for which there was valuation testimony. The New Haven Trustees, who prepared and circulated their valuation evidence in the latter part of 1966 asked their expert witnesses to use December 31, 1965, the most recent year-end data then available. Penn Central, which prepared its valuation evidence in rebuttal of the New Haven Trustees' evidence during the first few months of 1967, used the most recent year-end data available to it, namely that for December 31, 1966, which it used as its valuation date, except for real estate which was valued as of December 31, 1965. The Commission, writing in the latter part of 1967, used December 31, 1966 as its valuation date.

The procedure employed by both Penn Central's valuation witnesses and by the valuation witnesses for the New Haven Trustees was to determine values item by item as of the valuation date. The assumption of all of this evidence was that the physical process of liquidation would

begin as of the valuation date, and this was questioned by no one and was accepted by the Commission.

Penn Central made no suggestion before the Commission that this approach was improper—indeed, its own witnesses used the same approach—until its brief to the Three Judge Court in the spring of 1968; the Three Judge Court rejected its argument because it would involve a duplication of the losses which the bondholders had already sustained (289 F. Supp. at 438-39, App. 354-55a).

In fact, even on remand, the Commission's Examiner rejected any evidence offered by Penn Central on the claim that liquidation might be deferred past December 31, 1966 because of assumed delay in obtaining permission to abandon and on the purported consequences of such delay (Rec. 381c).

The rejection, we submit, was sound for the simple reason that in no sense which is properly cognizable in applying the standard of liquidation value in this case can it be fairly assumed that the start of actual liquidation could have been delayed beyond December 31, 1966. In fact, the thrust of the whole history of the reorganization of this railroad is that but for the prospect of inclusion, liquidation would have commenced long before the end of 1966.

The effect of the majority opinion of the Three Judge Court is to double the New Haven's injury. The New Haven has already suffered an actual erosion of its assets over the year 1967 by sustaining its substantial operating losses. The effect of the Three Judge Court majority opinion is to hypothesize abandonment delay costs which would also have taken place in the year 1967. Consequently, a second and overlapping set of 1967 costs is being charged to the New Haven for 1967 and to this extent the New Haven is required to accept less than liquidation value for its assets.

The attempt by the Commission to circumvent the teaching of *Brooks-Scanlon* and its sequels by inventing "refinements" in liquidation value as a "pricing out" of its authority to limit the right to abandon, cannot stand on its own merits and, in practical effect, may amount to a complete destruction of the liquidation value standard. If, as the Commission suggests, a hopelessly insolvent railroad can be compelled, in the public interest, to continue operations almost indefinitely as long as there exists some hope of rescue by inclusion and then, after it has sustained the enormous losses generated by those operations, can be charged further for future wastage of its assets, again in the name of the public interest, the door is open to complete destruction of any value in the bondholders' security. On the Commission's logic, there is no ascertainable limit on how far it can go in "adjusting" and "refining" liquidation value.*

The Absence of Substantial Evidence of the Effect of a Delay

Wholly apart from the unfair character of the Commission's adjustment theory, its factual analysis of the consequences of that theory is equally unsound and without support in the record.

What the Commission did was to assume that, by reason of the abandonment proceedings, liquidation would be de-

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* In this case, the Commission has taken a "net liquidation" value of $162.7 million and refined it downwards by $22.1 million, a reduction of about 12%, based upon a delay of a single year and a sale of the real estate "in bulk." It has claimed the right to at least double that effect by hypothesizing that the delay could have been two years or more and by applying its bulk sale theory to assets other than real estate. But the logic of the Commission's approach is far from exhausted. If one assumes further delays in the Commission's procedures, the process can be continued almost indefinitely.

layed an additional year, and that such delay would have the following consequences:

(1) Increase in the discount to present worth due to the delay of one year	$7,946,000
(2) Increase in preservation costs	4,940,000
(3) One year's accrual of real estate taxes	2,500,000
	$15,386,000

We shall discuss each of these items separately.

1. ***Increased Discount***

Probably the most important defect in the Commission's factual analysis is that it assumed that during a one-year delay the New Haven would not take any steps towards liquidation. In fact, the very cases cited by the Commission establish the opposite. In the *New York, Ontario & Western Abandonment* (I.C.C. Finance Dkt # 19861, October 10, 1957), the contract of sale was fully negotiated before permission to abandon was given (only three months after the application was filed). The fact is that, given the situation of the New Haven, as soon as the rail service terminated (assuming that there was not an immediate condemnation), the New Haven Trustees would be compelled immediately to begin to plan for an orderly liquidation of the railroad, including the immediate sale of non-operating properties, and to commence negotiating for the sale of other properties, subject to receipt of the abandonment certificate. Penn Central's own witnesses were asked by Penn Central's counsel to assume that the New Haven would dispose of a total of $15 million of non-operating property at the rate of $12 million in the first year and $3 million in the

second (Rec. 351-54c, excluding R-32, R-33). There is, we submit, no basis in the record or in common sense to assume that even assuming a one year's delay before the commencement of actual liquidation of property subject to an abandonment certificate, there would be any significant result beyond collapsing the bulk of the projected first year sales into the second year after the commencement of liquidation, and there can plainly be no basis for the Commission's assumption that all sales would be pushed back a year.

If only planned first year sales are affected, the consequence of the year's delay is only $4,148,000 rather than $7,946,000, as the Commission assumed.*

2. *Increase in Preservation Costs*

There was no competent evidence as to what preservation costs, if any, the New Haven would incur if it were prevented from liquidating its property for one year. The sole evidence of record is two sheets of paper (Ex. R-43, Rec. 374-75c), describing the expenses associated with a *temporary* cessation of operations, which was put in evidence through New Haven Trustee Smith. Mr. Smith admitted that he had not prepared the exhibit and he had no knowledge of how the figures on it were arrived at (Rec. 376-79c).

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* Actually, the only property directly affected by the certificate of abandonment would be real estate. Rolling stock can be severed and sold without an abandonment certificate, as can other forms of personalty. If the New Haven were to sell off such items pending abandonment, the effect of the delay in terms of discount would be even less than the text assumes. The figure in the text also disregards the effect of selling off non-operating real property and investments, a measure Penn Central concedes would be possible. This factor alone would further reduce the discount by $836,000 to $3,312,000. Finally, the figure in the text makes no allowance for the fact, recognized at other times by both the Commission itself and the Three Judge Court, that in the event liquidation were delayed, there is a significant possibility that, at least as to real estate, the market value would increase. (331 I.C.C. at 698, App. 56a; 289 F. Supp. at 438-39, App. 355a)

Objection was made on the basis that no foundation had been laid for its receipt and that it was incompetent unless there was testimony, subject to cross examination, on the source of the figures and how they were arrived at. The objection was withdrawn on the representation of counsel for the Trustees that the exhibit was offered to show what data Mr. Smith had in his possession when he concluded that the New Haven could not prudently continue operations beyond the beginning of 1969 (Rec. 382c). No other effort was made to qualify the exhibit for any other purpose. Thus, at least with respect to the purpose for which the Commission used this material, it is wholly incompetent, and the Commission had no right to rely on it.

What the Commission did in this case was, we submit, an almost exact parallel to the procedure which the Second Circuit condemned in *ABC Air Freight Company* v. *CAB*, 391 F.2d 295, 305 (2d Cir. 1968), where it wrote:

> "It is exceedingly dangerous business—indeed under some circumstances a denial of the fair hearing required by the APA—for an agency to seize upon a single exhibit in a large record, introduced for a limited and hardly controversial purpose, and make this an important basis for decision without benefit of cross-examination, rebuttal or argument. Compare *Ohio Bell Telephone Co.* v. *Public Utilities Comm'n of Ohio*, 301 U.S. 292, 304-306. . . ."

Exhibit R-43 was identified, on its face, as relating to the preservation costs of a temporary cessation of operations, with the intention of resuming operations later on. It was prepared for the internal use of the New Haven Trustees, by adapting available data (Rec. 325c, 376-79c). The exhibit has patent deficiencies, which its purpose makes understandable. For example, it assumes that rolling stock will be

"moth-balled" and that preservation costs, for protection and "moth-balling," would be about $1.25 million per year, about five times the allowances for such costs in the first year of liquidation (Rec. 378c). Common sense would suggest that, in the event of a permanent stoppage, the New Haven's first step would be to sell off its rolling stock; at the very least, it would default on those of its equipment obligations where the indebtedness exceeded scrap value ($8,740,000, as of December 31, 1965, according to the New Haven Trustees' evidence*) and thereby substantially reduce its preservation expenses. In fact, the preservation exhibit makes no allowance for payment on any of the equipment obligations. As a second example, the preservation cost exhibit assumes the same level of legal expenses, $1 million per year, as the Trustees' liquidation evidence shows would be spent in the first years of liquidation, when the bulk of the New Haven assets would be sold off (Rec. 375c). Yet, if the Commission's assumptions were correct, the New Haven would do nothing at all during its year's wait. Cross-examination of the individuals who prepared the analysis presumably would have developed other problematical aspects of the preservation cost estimate, but no such cross-examination was requested, or would have been appropriate, in view of the uncontroverted point for which the exhibit was offered.

3. *Increase in Real Estate Taxes*

The Commission apparently drew its figure of $2.5 million for increased real estate taxes from exhibit NHI-58, App. A (Rec. 118c). It disregarded the fact that there would be a countervailing increase in revenue as a result of the one year delay; Ex. NHI-58, p. 14 (Rec. 115c) shows that rental income from the real estate during the first year of

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* NHI-42, pp. 24-26, in Document No. 119 of the Three Judge Court record.

liquidation would be $1,000,000. Similarly, the New Haven would presumably receive an additional year's income from its interest in the Grand Central Terminal Properties, which the Commission has indicated in another context averaged $1,635,000 (*cf.* 334 I.C.C. at 39, App. 126a).

There is a second major deficiency in the Commission's analysis of the real estate tax increase due to a year's delay in liquidation. If, as we have argued above, the only consequence of a year's delay in obtaining leave to abandon is to defer the first year's sales into the second year after the liquidation decision, the increase in real estate taxes would not be $2.5 million as the Commission assumed, because there would be no change in the total real estate taxes paid on property sold, as planned, in subsequent years. There would be merely an additional year's taxes on property intended to be sold in the first year of liquidation, and this is shown by NHI-58, App. A (Rec. 118c) to be $1,263,591.*

Thus, the only increased costs due to a one year's delay in obtaining a certificate of abandonment which in any way are supported by proper evidence in the record are the following:

(1) discount	$3,312,000
(2) tax increase	1,263,591
	$4,575,591

which would be offset by an additional year's rent and an additional year's income from the Grand Central Terminal Properties, for a total offset of $2,635,000; thus the additional net cost of a one year's "freeze" in abandonment

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* Subtracting the amount of real estate taxes accruing in the second year of planned liquidation from the comparable figure for the first year.

would be about $1,940,000, rather than $15,386,000 as the Commission found.

The Three Judge Court conceded that all the foregoing "arguments are not without persuasiveness," but nevertheless concluded that they are "offset" by the Commission's failure to deduct a further year's depreciation of $3,000,000 and to place the abandonment delay at over 2 years rather than at 1 year. These "offsets" are insufficient in amount. Moreover, the majority's effort to buttress the Commission's conclusion by references to steps which the Commission might have taken is legally untenable in view of this Court's decision in *SEC* v. *Chenery*, 318 U.S. 80 (1943).

B. The majority of the Three Judge Court attempted to sustain the Commission's "bulk sale" discount of $6.695 million on the basis of an analysis which the Commission did not make and which is not supported by the record. The Commission's rationale is further erroneous as a matter of law.

In addition to the $15,386,000 abandonment delay adjustment, the Commission further "adjusted" the liquidation value of the New Haven by an additional reduction of $6,695,000 based upon its purported power to limit "the right to break up the railroad" (334 I.C.C. at 60, App. 147a). It argued that since it had the power to compel a sale in bulk to one who would undertake to operate the railroad, this implied the power to reduce the price below net liquidation value (334 I.C.C. at 60, App. 147a). In response to the bondholders' argument that even a bulk sale buyer must pay what the seller could obtain in liquidation the Commission said: "Our answer is that we may compel the bulk sale *and the bulk sale discount* as a condition of an abandonment certificate, and, therefore, as a reduction of the present price." (334 I.C.C. at 61, App. 148a; emphasis supplied.)

All of the reviewing judges rejected the Commission's analysis. The majority opinion in the Three Judge Court observed:

> "... we would suppose that the constitutional right to abandon operations implies a right to break up the railroad and sell the parcels for their highest and best prices." (App. 417a)

It went on to note that the Commission's power to compel a sale of a whole line, at its salvage price, to a purchaser who will continue railroad operations has little to do with the evidence on bulk sale discount which contemplated a sale to one who would abandon and break up the road.

In fact, the Commission's assertion of a power to compel a "bulk sale discount" as a condition of abandonment was contrary to its consistent disposition of abandonment cases. See *e.g., Tennessee Central Ry. Co. Abandonment,* 331 I.C.C. 433, 454-55 (1968); *New York Central R.R. Co. Acquisition of Chicago, Attica & Southern R.R.,* 187 I.C.C. 527 (1932); *New York Central R.R. Co. Acquisition of Boyne City, G&A. R.R.,* 180 I.C.C. 538, 564-65 (1932); *Jay Street Connecting R.R. Abandonment,* 307 I.C.C. 137, 163 (1959). In those abandonment cases, while the Commission required the seller to sell property in one piece to a buyer willing to operate the road, it was careful to note that the obligation was conditional upon the seller obtaining a price at least equal to "scrap value" and never made any suggestion that this price was subject to a discount.

But after rejecting the Commission's rationale, the majority of the Three Judge Court proceeded to construct a new theory, that the bulk sale adjustment was intended to take into account certain risks which the previous analysis had overlooked. On this analysis, it sustained the Commission's adjustment. The majority discerned this "risk

theory" in the following remarks of the Commission: "The bulk sale discount merely reflects a market appraisal of the risks that the estate avoids, and that the bulk buyer assumes" (334 I.C.C. at 61, App. 148a); and a statement that the discount "fully recognizes, without conceding, NH's right to abandon and liquidate the estate." (334 I.C.C. at 63, App. 150a). The majority observed that these remarks were "not pellucid" (App. 417a). Judge Weinfeld described the majority's approach in these terms:

> "they purport to find justification for its acceptance by culling other statements from the Commission's report and deducing therefrom what the Commission really intended, to wit, a 'discount as a proper measure of risks not taken into account by the appraisals and the discount to present value.' Passing for the moment that this is not at all the theory relied upon by the Commission, which at once raises a question as to whether the agency action can be upheld,[22] the theory when tested on the basis of what the Commission did, as opposed to what it might have done, is clearly erroneous and cannot prevail. The Commission's determination rests upon its assumed power to compel the bulk transfer to assure 'the continued operation of the property and preservation of its unity.'[23] However, the evidence upon which it justified the bulk sale deduction contemplated the sale of the real estate to a private developer who was in no way committed to the 'continued operation of the property and preservation of its unity.'[24]

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[22] *SEC* v. *Chenery Corp.*, 318 U.S. 80, 94 (1943).
[23] 334 I.C.C. at 61.
[24] R-29; T. 29799 et seq."

(App. 439a)

As Judge Weinfeld noted, the theory attributed to the Commission by the majority of the Three Judge Court is altogether different from the one actually relied on by the Commission, a practice which this Court condemned in *SEC* v. *Chenery Corporation,* 318 U.S. 80, 94 (1943). Moreover, it is contrary to the evidence, which shows (1) that the valuation originally developed by the Commission took all of the risks into account and (2) that the "bulk sale" theory was based, not on risks, but on the cost of entrepreneurial money.

The New Haven's liquidation studies on real estate were prepared in large measure by its own real estate department staff, which had already gained great experience from a long-term program of selling.

The real estate appraisal work of the New Haven staff was reviewed in considerable detail by independent appraisers, the Boston firm of Meredith & Grew. Major parcels in New Haven and New York City were independently appraised —these specific independent appraisals cover approximately 25% of the total New Haven real estate in terms of market value. In conjunction with their appraisal of the property, the New Haven witnesses prepared estimates of the direct cost of sales, including brokerage fees, promotional expense, taxes and legal fees and developed estimates of the overhead cost associated with the New Haven's own personnel, particularly its real estate and legal departments and its management. The estimated fair market value of the real estate was reduced by $8,178,000, a discount of about 7.2% based on the judgment of the appraisers that this amount would be lost in "distress sales" at the end of the liquidation period. The New Haven witness added a discount of 6% to adjust future receipts to present worth. (Rec. 206c, 227c).

As a result of the allowances for liquidation expenses, and the discount for distress sales, the gross liquidation value of the New Haven real estate was reduced by $24,149,000 (331 I.C.C. at 661-62, App. 19-20a) and further reduced by a discount to present worth (attributable to the real estate proceeds) in excess of $11 million.*

Thus, even disregarding overhead expenses, the New Haven Trustees' evidence showed that the present worth of its net receipts from the sale of real estate having a market value of $113.7 million, would be not more than $78.6 million. Over $35 million of value would be lost through sale expenses, totalling $15.9 million, and measures against risk, totalling $19.2 million.

Penn Central presented a rebuttal case on the valuation of the real estate, based on appraisals made by Central's real estate department personnel and an independent appraisal of the New Haven's Oak Point and Harlem River Yards.

Penn Central also presented a discount analysis, which took into account the risks involved in selling the property as well as the cost of money, on which basis they adopted a discount rate of 7% for a 10 year liquidation (Rec. 181-88c).

After reviewing all of this evidence, the Commission accepted the real estate valuation of the New Haven witnesses and also adopted their discount rate of 6%.

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* This computation assumes, as the Commission has held, that Mr. Gordon's figure for discount of gross receipts is correct. As we will argue at pp. 74-78 *infra*, in computing the discount of liquidation value, it is improper to treat as a receipt the $8,178,000 reduction at which it was assumed distress sales would occur. On this analysis, the discount attributable to net real estate receipts would be $9 million.

The sole evidentiary basis for the Commission's "bulk sale" theory is the testimony of Robert E. Simon, who admitted that he had never seen any of the valuation study evidence or even the Inclusion Report of the Commission, that he did not understand the theory or function of discounting and that his prepared testimony (which discussed "discounting") was written by someone else (Rec. 456-59c, 476-80c, 483-85c).* Nevertheless, Mr. Simon proceeded to criticize the approach of all of the valuation witnesses based on what he considered to be the distinction between a sale "in bulk" and a "retail" sale** without defining either term, enumerated risks which he considered that the Commission had not considered (although all of these risks were raised by the valuation witnesses whose testimony Mr. Simon had never seen), and then developed an analysis, not in terms of "risk", as the Three Judge Court assumed, but in terms of "the cost of money invested." Mr. Simon's method of quantifying the "cost of money invested" was to assume that the purchaser in bulk would borrow 75% of the price at which he bought the property, to be secured by a 9% mortgage, and advance the remaining 25% out of his own funds, for which he would expect a 15% return to cover his entrepreneurial activities.

This was the approach which the Commission adopted. It postulates a middleman, who buys in bulk for resale to retail users of land. While such a method of disposal is one of the possible courses a prudent management would

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* For the convenience of the Court, we have reproduced the testimony of Mr. Simon in its entirety, at Rec. 346-50c, 446-98c. The full text of the testimony shows, as no excerpt can, how far divorced Mr. Simon's discussion was from the valuation evidence in this case.

** There is no basis to assert that the original appraisals contemplated merely retail sales, in view of the stated assumptions of the Penn Central study (NHI-95, pp. 8, 9, in Document No. 122 of the Three Judge Court record).

investigate,* and presumably reject as too low in this case, it is not one which can be compelled by law and finds no support in the Commission's prior decisions. The Reorganization Court has held that it is not a method of disposal which it could approve under Section 77(b)(5) of the Bankruptcy Act (304 F. Supp. at 805-06, App. 292-93a).

The Reorganization Court, in its decision of May 28, 1969 held that according to its definition of fair liquidation value—"what the market would pay" (304 F. Supp. at 805, App. 293a)—the effect of the bulk sale discount would be to force the creditors to accept less than liquidation value.** In this case, the Reorganization Court said, the best price the market place will give is not determined by looking to a wholesale or even a retail market for all of the New Haven's properties. Rather, what must be looked to in determining value is the market value which was carefully developed in the evidence, one envisioning a piece-by-piece disposition. The Court concluded:

> "The Commission and Penn Central urge that Penn Central should be credited with a bulk sale discount for removing from the debtor's estate the risk of non-sale or sale below fair market value. But the computation in arriving at fair liquidation value has already deducted $8,000,000 for this purpose, in addition to costs and expenses attending the sale of the properties.

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* Other possible courses would seem more attractive, such as the parcel-by-parcel sales which the original valuation studies of the New Haven Trustees and Penn Central envisioned, or the sale of large segments of the railroad on the basis of the probable interest of likely customers, including other railroads as well as real estate investors, operators and developers.

** Judge Weinfeld agreed: "[the bulk sale theory] deprives the bondholders of the salvage value of their property anticipated under the six-year liquidation program and at once raises constitutional issues." (App. 438a)

It is true that a bulk purchase would eliminate all of these expenses and the risks of marketing the properties over a span of 6 years, but in arriving at fair liquidation value, which is a net value, all of these items were deducted. Now the I.C.C. would give Penn Central an encore—the gift of a double deduction." (304 F. Supp. at 806, App. 293a)

The Reorganization Court held that the Commission had violated the Bankruptcy Act and the Constitution by compelling the New Haven to accept less than fair liquidation value since both the Act and the Constitution prescribed fair liquidation value as the mandatory minimum to be awarded the creditors. (304 F. Supp. at 806, App. 293-94a)

Both the Reorganization Court and Judge Weinfeld were correct, we submit, in concluding that the effect of the bulk sale adjustment was to deprive the New Haven of liquidation value, by duplicating deductions already allowed for. The Reorganization Court was plainly correct in noting that the method of sale Mr. Simon proposed was one it could not approve.

POINT II

The Decisions of the Reviewing Courts, While They Recognize That the New Haven's Right to Fully-Paid Access to and Use of Grand Central Terminal May Be a Valuable Asset, in Fact Accord This Asset No Value in Determining the Liquidation Value of the New Haven, and the New Haven Receives Nothing for $5,600,000 of Annual Income Now Used Without Restriction by Penn Central.

In its Remand Report, the Commission increased its valuation of the New Haven's interest in the Grand Central Terminal Properties* from $13,000,000, as it had found in its Inclusion Report (331 I.C.C. at 684, App. 42a), to $28,887,000 (334 I.C.C. at 39, App. 126a).** The entire interest in these properties (both the New Haven's interest and the interest of the New York Central, now Penn Central) had been valued by the New Haven Trustees' appraiser at $227,225,000 as of April 19, 1965 (Rec. 23-26c). This valuation was not disputed.

The reviewing courts and the Commission have all held that the New Haven, as Penn Central's partner in the development of the Grand Central Terminal Properties, is entitled to 50% of the "excess income" from those prop-

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* The Grand Central Terminal Properties include the terminal itself, the Waldorf, Barclay, Biltmore, Roosevelt and Commodore Hotels and numerous office buildings along Park, Lexington and Madison Avenues, many of which, such as the Pan Am Building, are new and quite large.

** The Reorganization Court and the Three Judge Court modified the Commission's award of $449,000 for accrued and unpaid "excess income" for the years prior to 1969 (304 F. Supp. at 806-07, App. 295a; App. 422a). Following the court's direction, the Commission increased the allowance in its Fifth Supplemental Report to $3.38 million (334 I.C.C. at 529, App. 223a).

erties, *i.e.* the $4,500,000 of annual income in excess of that used to defray Terminal expenses (334 I.C.C. at 30-32, App. 117-20a; 304 F.Supp. at 463, 253a; 289 F.Supp. 431-32, App. 295a; App. 418a). However, neither the Commission nor the Courts have attributed any value to the New Haven's right to have its $5,600,000 share of Terminal income used to defray its share of Terminal expenses for purposes of determining the fair price Penn Central should pay. The result is that of the $13,850,000 of gross income which Penn Central used in 1969 to pay Terminal expenses and which it continues to use, $5,600,000 is income which is attributable to the share of the joint venture which belonged to the New Haven before the sale of the New Haven assets and which came to Penn Central as part of the sale. Yet Penn Central is being charged nothing for this very substantial asset.* By refusing to allow the New Haven any capitalized value for this right to income, the Commission and the reviewing courts have in effect imposed on the New Haven creditors a perpetual subsidy of the cost of operating Penn Central's New Haven Division trains into the Terminal.

The New Haven's share of the income from the Grand Central Terminal Properties is not merely the "excess income" of $2,275,000 capitalized by the Commission but that amount increased by the $5,600,000 which Penn Central is now using without any restriction as to source. At any

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* In its brief of April 17, 1968 to the reviewing courts (p. 137), Penn Central commented:

> "The value of the New Haven's right to have the G.C.T. income credited against the New Haven's share of operating expenses has been tremendous. . . . As Mr. Grant [then Central's Vice President-Finance] testified, the New Haven's free entrance without cost into Grand Central Terminal [is] the biggest bargain in the railroad industry."

The effect of the decisions below is to transfer this "tremendously" valuable right for nothing.

reasonable capitalization rate this results in a valuation of the New Haven's interest in the Grand Central Terminal Properties far in excess of the $28,887,000 found by the Commission.

The Three Judge Court concluded, in its opinion of July 10, 1968, that this right of the New Haven to fully-paid access to the Terminal and the $5,600,000 used for the purpose was without real value on the grounds that "there is no assurance NH will have a successor" (289 F. Supp. at 431, App. 339a) and that if its successor were the State of New York, "which is highly uncertain, it might well elect to operate only a connection with the New York City subway system rather than bear the heavy expense of an elaborate terminal that was constructed to serve trunk as well as commuter traffic." (289 F. Supp. at 431, App. 340a). On the other hand, the Reorganization Court, in its opinion dated August 13, 1968, concluded that the right represented "a valuable interest" which Penn Central would acquire "[w]hether an authority will take over New Haven's commuter operations and succeed to this right, which the New Haven now has, or Penn Central succeeds to that right." (289 F. Supp. at 463, App. 253a). The Reorganization Court directed the Commission to "make findings" as to what value, if any, attached to that right.

In its Remand Report, the Commission stated, "In liquidation the right to free use of the terminal would have no value to NH unless there was a buyer willing to pay for the use." (334 I.C.C. at 32, App. 119a). The Commission then concluded that the only potential buyer was the State of New York and that the right was valueless in those circumstances because the bargaining power of the State was so great that it would not "need to bid for free use of the terminal." (334 I.C.C. at 32, App. 119a). The Commission added that "We agree with the three-judge court that no

such buyer is in sight, that the State of New York would need to *pay for only the net cost of operating into the terminal. . . .*" (334 I.C.C. at 32, App. 119a; emphasis supplied).*

In its decision of May 28, 1969, the Reorganization Court referred to its earlier direction to the Commission to make findings as to the New Haven's "valuable interest" in its right of access to the terminal but concluded that it was "now satisfied that the Commission's treatment of the matter must stand." (304 F. Supp. at 806, App. 294a). Later, however, in its Memorandum dated July 2, 1969, the Reorganization Court indicated that its decision to accept the Commission's conclusion of no value was not free from doubt and stated that if the right of fully-paid access were fully recognized it would have a potential worth of approximately $70 million (App. 314a).

In its decision of June 18, 1969 (App. 419-20a), the Three Judge Court majority recognized that if someone could be found to take over the New Haven's operations into Grand Central Terminal, the right of fully-paid access would be a saleable right (App. 419a). But the court concluded that the State of New York was the only potential buyer, and that the State would not be likely to pay much for the right of access. The court wrote:

> "Unless someone could be found to take over NH's operations into GCT, the right to have terminal income

* Apparently, Penn Central has in fact reached agreement with New York and Connecticut. In fact, since the record in this case was closed, it has been announced in the press that a joint instrumentality of New York and Connecticut has agreed to acquire the New Haven commuter service from Penn Central. We understand that as part of this agreement, the Commuter Authority will lease from Penn Central the tracks between Woodlawn, N.Y. and the Terminal and partial use of the Terminal itself under terms whereby it will pay $2.9 million per year. New York Times, November 26, 1969, pp. 1, 32.

applied to expenses could not be sold to anyone even if the anti-assignment clause in the contract was not the obstacle that it may be. While it may well be that the State of New York would not allow all of NH's commuter services to disappear, there is no assurance in this respect and still less assurance that the State would operate into GCT if it had to pay the NH estate the full capitalized value of NH's right to set Terminal income off against Terminal expenses. Indeed, the State, if it wished to continue using GCT, might well be able, either through its own bargaining position or the power of the ICC, to obtain a transfer of this right without making any payments to NH that would increase the 'liquidation value' of this unique type of asset above the sum that could be realized if the State were not a buyer." (289 F.Supp. at 431, App. 419-20a).

It seems clear that both the Commission and the reviewing courts agree that the right of fully-paid access to the Terminal which the New Haven owned until the closing of the sale to Penn Central on December 31, 1968 is a valuable right if a buyer can be found. The fact is that there is at least one buyer and probably two. The first is Penn Central itself, which was compelled to acquire the property by reason of its own Purchase Agreement and Condition 8 of the Commission's order approving the Penn Central merger (quoted in the second footnote at p. 11, *supra*) which Penn Central accepted by merging. As the actual buyer, Penn Central, since January 1, 1969, has been receiving the full benefit of the $5,600,000 of income. Since the use of the $5,600,000 is no longer restricted by any agreement with the New Haven, that amount, as well as the remainder of the $13,850,000, is available to Penn Central for any corporate purpose it may choose.

The other buyer may be a joint instrumentality of New York and Connecticut. Penn Central is now (and was known at the time of the decisions to be) negotiating with Connecticut and New York to arrange for a New York State—Connecticut authority to take over its New Haven Division commuter operations into Grand Central Terminal with Federal aid (304 F.Supp. at 800, App. 284a). Whatever form that arrangement may finally take Penn Central will have obtained some consideration for the use of the Terminal which it now owns free and clear of the New Haven's rights. *Prima facie,* as the Commission recognized (334 I.C.C. at 32, App. 119a), the result of such arrangement would be that the commuter authority would pay the "net cost of operating" the New Haven Division trains into and out of the Terminal. Based on the record, that cost at present must be taken to be approximately $5,600,000 per year.*

Subsequent events have shown that any doubts that the State of New York would be a buyer are unfounded and seem to indicate that the Commission was correct in assuming that the commuter authority would pay the "net cost of operating" into the Terminal those of the New Haven Division trains which it acquires (See footnote to p. 59 *supra*).

Penn Central has now had the use of $5,600,000 for more than a year. Even on an uncapitalized basis and disregarding the future, the New Haven would be entitled to $5,600,000 for the year 1969. If Penn Central concludes its transactions with the states of New York and Con-

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* Depending upon the nature of the transaction, it may be necessary to reduce this "net cost" figure by the allocated cost of New Haven long-haul passenger service, if Penn Central continues to be responsible for that service. Press reports indicate that the pending arrangement between Penn Central and New York and Connecticut relates only to the transfer of commuter service.

necticut and the Federal Government in 1970—for example on July 1, 1970—Penn Central would have used $8,400,000 of New Haven funds up to that date. What it may choose to accept from the New York-Connecticut commuter authority from the day of closing of the transaction forward is its own concern and subject to its own negotiations. What Penn Central chooses to do with the income-flow it has acquired is beside the point.

The value of the New Haven's right, we submit, is the capitalized value of an annual income of $5,600,000 or about $70,000,000 using the Commission's capitalization rate of Grand Central Terminal "excess income" of 8%. This conclusion, we submit, is not changed if, as the result of bargaining, the amount paid by the States is less than $5,600,000 per year or even if Penn Central elects to bargain away this interest in whole or in part in order to get other advantages.

The Three Judge Court also rejected, for lack of evidence, the bondholders' point that, at the very least, if, on the liquidation hypothesis, the New Haven's operations were discontinued, there would be a corresponding decrease in Terminal expenses and therefore an increase in the "excess income" (289 F. Supp. at 431, App. 340a; App. 420a). This view is correct only if it is proper to thrust the burden of proof of this point on the bondholders. We submit that, once it was established that the costs would decrease, a seemingly obvious point given the fact that if the New Haven were discontinued, car entrances would decline by 41%, the more appropriate course is to require Penn Central, as one of the Petitioners, to establish what savings would result since it, rather than the bondholders, had the data necessary to determine with precision what would occur.

POINT III

The Attempt of the Reorganization Court, Adopted by the Majority of the Three Judge Court, to Remedy the Commission's Gross Overvaluation of Penn Central Common Stock by Means of an "Underwriting" Fails to Cure the Overvaluation and Thus Leaves Unremedied the Substantial Imbalance Between the Value of the Assets Sold and the Value of the Consideration Received.

As the major portion of the consideration for the assets it sold to Penn Central, the New Haven, on December 31, 1968, received 950,116 shares of Penn Central common stock. In both the Inclusion Report and the Remand Report, the Commission valued the stock at $87.50 per share, a total of approximately $83.1 million; thus stock represented about 60% of the total value the Commission assigned to the consideration which Penn Central was to pay (331 I.C.C. at 688-90, 692; 334 I.C.C. at 68; App. 46-48a, 50a, 155a). At the end of 1966, the valuation date which the Commission used with respect to the New Haven assets and to the bond portion of the consideration, the average price of Penn common stock on the New York Stock Exchange was 52⅜.* On December 31, 1968, the date of the inclusion, Penn Central stock closed at 63⅜. The market price of the stock has steadily declined; the market price was 54-54¾ at the time of the Reorganization Court's opinion (May 28, 1969) and 48½-50½ at the time of the Three Judge Court opinion (June 18, 1969); on February 20, 1970, it closed at 26¼.

In their decisions on review of the Remand Report, both courts rejected the $87.50 valuation as inflated (304 F.

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* Penn was the surviving entity and its shares were treated on a 1-for-1 basis at the time of the merger.

Supp. 809, App. 299-300a; 429-30a). In its decision of May 28, 1969, the Reorganization Court noted the bondholders' objections that it is "unfair to charge the New Haven's estate with having received $83.1 million when the form in which it was received could be acquired on the open market for about $20,000,000 less." (304 F. Supp. at 809, App. 299a) After referring to the theory that the issuance of shares of stock would assist Penn Central "by relieving it of the need to divest itself of a crippling amount of cash, which would be prejudicial to its merger program", the Reorganization Court stated:

> "There is an element of unfairness, however, in the fact that the New Haven has transferred assets conservatively worth what the liquidation value says they are worth. The purchase price, to the extent of $83.1 million and fully credited to the purchaser as $83.1 million paid, is not worth $83.1 [million] on the present market. It is credited as $83.1 [million] paid, on an assurance or assumption that the 950,116 shares will be worth that sum and more, but when and who will make good on that assurance is not known or not stated. The ordinary purchaser of shares of stock takes it subject to his losing or gaining on the money he put into it. But the New Haven is not that kind of a purchaser; it is being compelled to take it at a substantial present loss on an assurance of future gain, but suppose the shares never go to 87½ in the whole ten years to February 1, 1978.
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> "The nub of the unfairness and inequity is not the 87½ fixed for present calculations, but the fact that the purchaser is getting assets of sure present value while the seller is asked to gamble for its payment on the future of the Penn Central." (304 F. Supp. at 809, App. 299-300a)

The Reorganization Court attempted to meet the problem it had thus defined by providing for an "underwriting" formula whereby Penn Central must, in essence, pay the difference between the average market price of the shares in the 30-day period prior to February 1, 1978 and $87.50 per share, unless Penn Central stock reaches and maintains a price of $87.50 for five consecutive days in the approximate nine-year period intervening (304 F. Supp. at 809-10, App. 300-01a).*

In its June 18, 1969 opinion, the majority of the Three Judge Court essentially adopted the formula devised by the Reorganization Court (App. 430a).** Judge Weinfeld dissented, however, on the ground that the New Haven was entitled to the equivalent of $83.1 million as part of the purchase price and that the "underwriting" was not an acceptable solution.

> ". . . The question of the stock valuation appears to have received little or inadequate consideration by the Commission. As my brethren note, the sole discussion of this important problem was a *rather cavalier brush-off* of the bondholders' challenge to the

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* The decision also permitted Penn Central to fix its liability by designating in advance a "valuation date" for a specified number of shares, and paying for each share the difference between $87.50 and the market price of Penn Central stock on that day. The designated shares would thereupon have no further rights under the underwriting.

** The order of the Three Judge Court dated September 11, 1969 which provides for its version of the "underwriting" is somewhat more detailed than the order of the Reorganization Court on the same subject but there do not appear to be substantial differences. The order of the Three Judge Court does, however, provide that the parties are to cooperate in the preparation of an instrument to implement the provisions of the order as to the "underwriting" and that if the parties are unable to agree, the form of the instrument is to be determined by the Reorganization Court. The instrument is to provide that disputes in reference to its application are to be determined by the Reorganization Court (App. 452a).

> Commission's valuation of the stock at $87.50 per share.[27] The New Haven estate is entitled to the equivalent of $83.1 million as part of the purchase price. After hearing the parties upon a remand, the Commission may require the issuance of a larger number of shares or otherwise provide for that sum.
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> [27] 334 I.C.C. at 68 n. 40."
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> (App. 441-42a; emphasis supplied)

The Commission has apparently accepted the "underwriting" in principle (334 I.C.C. at 532, App. 226a).

While the "underwriting" formula is a substantial improvement in the terms of inclusion, it nevertheless falls far short of what the New Haven is entitled to. In the first place, since the obligation is neither secured nor entitled to any priority over general creditors, the "underwriting" formula fails to accord the New Haven any protection against the risk of insolvency or reorganization of Penn Central during the intervening nine years, during which the New Haven's rights under the "underwriting" cannot be transferred. In the second place, the "underwriting" formula disregards the fact that a payment to be received nine years in the future is worth substantially less than a payment made today. Assuming a 6% discount rate,* the one generally used by the Commission, and using the market price (48½-50½) of the stock at the time of the Three Judge Court's decision (June 18, 1969) the value of the stock portion of the consideration (including the "underwriting") which the New Haven has received

* Of course, a discount rate higher than 6%, which may seem more appropriate in the present money market, would give a significantly lower present value; thus, at a 6% rate, $1 to be received in 9 years would be worth 58.1 cents; at an 8% rate it would be worth only 48.5 cents.

was at least $15 million less than the $83.1 million value assigned to the stock by the Commission.*

The New Haven lacked effective control over the Penn Central stock and had no right to rely upon the underwriting at least until the expiration of Penn Central's time to appeal from the order of the Three Judge Court (entered on September 11, 1969) which occurred on December 10, 1969. The market price of Penn Central stock on that date was 28⅝-29¼, an average of 28-15/16. At that price, the stock was worth only $27,494,000 and the value of the stock (at market) plus the present value of the underwriting was $59,822,000, or $23,314,000 less than the Commission's valuation.

Thus, even after taking the "underwriting" formula into account, the consideration paid by Penn Central was worth at least $15 million less than the adjusted net value assigned by the Commission to the New Haven assets at the time of the Three Judge Court's decision and was at least $23 million too low by the time the New Haven's right to the "underwriting" was fixed as to Penn Central. This result is wholly contrary to the constitutional and statutory standard of fairness and equity, namely, substantial equivalence between the value of the assets sold and the value of the consideration paid, which both the Commission and the court's have found applicable here.

We submit that the underwriting formula is also deficient in the following respects:

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* At the time of the Three Judge Court's opinion (June 18, 1969), the market value of the stock was approximately $47.0 million, or about $36.1 million below the Commission's value of $83.1 million. The present worth of $36.1 million payable nine years hence, is only about $21.0 million. Thus, the value of the stock plus the present value of the "underwriting" was then only $68.0 million.

(1) The terms of the "underwriting" should be modified so as to protect the New Haven against impairment of Penn Central's ability to perform its underwriting obligation during the extremely long period of time that the New Haven's right is delayed. One desirable step in this direction would be to substantially reduce the term of the "underwriting". We would suggest a period of five years from December 31, 1968 as being more equitable.

(2) The number of shares to be delivered under the "underwriting", in satisfaction of Penn Central's obligation, should be increased so that the market value of the stock plus the discounted value of the underwriting equals $83.1 million (apart from the increases in this consideration required by the other points raised in this brief). Using December 11, 1969 as a valuation date for this purpose, the increase in the number of shares necessary to meet this standard would be 370,300 shares using a discount rate of 6%, and 499,700 shares using a discount rate of 8%.

(3) The conditions under which the "underwriting" of the $87.50 price is terminated with respect to certain shares should be modified. It is unrealistic to assume that any block of Penn Central shares as large as the amount involved in this case could be sold within five trading days (normal daily transactions in Penn Central appear to be in the order of 10-20,000 shares); the period during which Penn Central shares must remain at or above $87.50 should be increased to at least three months (this would provide about 60 trading days, barely enough for an orderly liquidation). On similar grounds, we accept the point made by the Second Mortgage Trustee as to the undesirability of a further clause in the underwriting, namely, that permitting Penn Central to fix its obligation with respect to any block of 50,000 shares by paying the difference between $87.50 and a predesignated spot price.

POINT IV

The Majority of the Three Judge Court Erred in Affirming the Commission's Decision to Accept One Appraisal of the New Haven's Harlem River and Oak Point Yards, and Reject an Appraisal $4.5 Million Higher, Because This Decision Was Unconstitutionally Made on the Basis of Matters Dehors the Record and Is Not Supported by Substantial Evidence.

The New Haven's Harlem River and Oak Point Yards are two large freight yards, about a mile apart and totaling about 160 acres, located in the Southeast Bronx. The Oak Point Yard also serves the Hunts Point Market, a large modern produce facility constructed by the City of New York to consolidate wholesale produce marketing operations at a cost of over $100 million, which opened in 1967.

The Commission, in its Inclusion Report (331 I.C.C. at 668, App. 26a), accepted the second and lower of two appraisals made for the New Haven Trustees by Mr. Arthur McCann. On review, the Three Judge Court disapproved the Commission's conclusion on this point, noting that it had inadequately explained why it chose the $18.1 million appraisal rather than the other McCann appraisal of $22.65 million, or the $26 million appraisal of the bondholders' witness, Mr. O'Keefe (289 F. Supp. at 434, App. 345a). In a memorandum denying Penn Central's motion for reconsideration, the Court suggested that the Commission consider the significance of the "proximity of a line of Penn Central" (App. 386a).

On remand, Mr. McCann testified that the difference in his appraisals was accounted for by his assumption in the

higher one that "rail service" would be available.* (Rec. 388-89c) He confessed that at the time he made his appraisals he was unaware that there was an existing rail line running from Penn Central's Port Morris Branch to the New Haven's Oak Point Yard. Thus, notwithstanding the liquidation of the New Haven, there would be a rail line up to the edge of the Oak Point Yard; this access made possible a physical connection over about two miles of existing New Haven right-of-way to the Harlem River Yard (Rec. 194c).

Penn Central's witness, Frederick E. Weaver, testified that, if the New Haven were liquidated, Penn Central would not be willing to serve new industry locating in the New Haven Yards or continue rail service to the City's Hunts Point Market and could not be compelled to do so. He cited as his reasons for this conclusion clearance problems over Penn Central's Port Morris Branch and switching problems in handling traffic to the market (Rec. 341-45c). Mr. Weaver, on cross-examination, admitted that "someone" would have to provide rail service to Hunts Point Market and that such service would have to move from Penn Central via the Oak Point Yard (Rec. 401c).** This bears out the assumption in the appraisal of the two yards made by Penn Central's own witness, Mr. White, that there would be rail service (Rec. 194c).

There was no suggestion in Penn Central's direct evidence that traffic to the Hunts Point Market and to in-

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* Mr. McCann explained that, based on his experience with other industrial parcels in the Bronx, he had found that land with "rail service" sold at about 10% higher than land without "rail service" (see Rec. 388c).

** When examined about clearance problems on the Port Morris Branch, he conceded that there were only two apparent constrictive points and that such difficulties as might arise might be met by relocating track within the existing right of way (Tr. 29732-34, 29738-39, filed in Document No. 49 of the Three Judge Court record).

dustry locating in the two yards would be unprofitable, particularly if Penn Central were no longer obligated to divide revenues with the New Haven, and there is no evidence in the record that this might be the case.*

In its Remand Report, the Commission nevertheless adopted the argument made in Penn Central's brief that it would not handle such traffic because it was not profitable. The Commission based this finding upon material outside the record, drawing upon data in its files from a survey made in 1965, before Hunts Point Market was constructed and before there had been at least two general rate increases (334 I.C.C. at 45-47, App. 132-34a). The parties had no notice of this data until the Commission published its decision.

Thus, the key factor in the Commission's decision on the value of the Oak Point and Harlem River Yards, namely whether there would be rail service to those yards, a fact Penn Central's own witness had assumed (Rec. 194c), was made by the Commission to turn upon a question, namely, whether Penn Central would serve Hunts Point, where Penn Central's witness had admitted "someone" would provide such rail service, and then resolved solely

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* The Commission refers on three occasions at p. 45 of its Remand Report (334 I.C.C. at 45, App. 132a) to "testimony" of Penn Central that it finds perishable traffic, the bulk of the Hunts Point traffic, "unprofitable". There is no such testimony; in its brief below, Penn Central could point only to the following scraps—(Tr. 29414 and 29421, in Document No. 48 in the Three Judge Court record)—where Hunts Point traffic is described as "predominantly perishable"; Rec. 398-400c—where Mr. Weaver stated that, after his testimony was circulated, he had been shown traffic studies made by others (he was not permitted to describe them); and Rec. 403c—where Mr. Weaver testified that he would not recommend Penn Central's operating to Hunts Point on the basis that "I don't think it's a profitable proposition for a capital investment of that size", and then admitted that he didn't know how much revenue could be obtained from such an operation or how much of an investment would be necessary. (Rec. 403c).

on the basis of irrelevant matter dehors the record, without prior notice or any opportunity for cross-examination or rebuttal or even argument. This procedure, we submit, deprived the Appellants of a fair hearing and due process of law. *United States* v. *Pierce Auto Freight Lines,* 327 U.S. 515 (1946); *Ohio Bell Telephone Co.* v. *Public Utilities Comm'n,* 301 U.S. 292 (1937); *Sayer* v. *Gardner,* 380 F.2d 940, 954-55 (6th Cir. 1967).

Despite the due process and fair hearing problem raised by the Commission's resort to material outside the record and the substantial evidence problem raised by the fact that the conclusion of the Commission had no support in the evidence, the majority of the Three Judge Court affirmed the Commission on the ground that the "probable scope of future rail service to these properties in the event of liquidation of NH" was within the Commission's "expertise".* (App. 423a)

The Reorganization Court and Judge Weinfeld in dissent both held that the Commission's decision was in error because it was not supported by substantial evidence. Both held that the fair value of these yards, on the basis of the evidence, was at least the higher McCann appraisal of $22.7 million. (304 F. Supp. at 808, App. 297a; App. 442-43a)

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* Moreover, the majority was of the opinion that even if it assumed Penn Central would continue rail service to Hunts Point via the Oak Point yard, that "would not necessarily entail the conclusion necessary to compel adoption of the higher figure." (App. 423a). This remark misses the fundamental point, that the Commission's conclusion is bottomed at best on insubstantial and improper evidence and also disregards the appraiser's quite blunt testimony that the higher appraisal assumed there was rail service and the lower one assumed there was none.

The Reorganization Court noted a further point admitted in effect by Penn Central's witness:

> "To assume that the State and City of New York would stand idly by and permit the lifeline to its huge and costly enterprise to be cut just as it is in the midst of planning its necessary enlargement, because it was unwilling or unable effectively to bring pressures to bear or take steps on its own to preserve the connection with Penn Central is absurd, even if the I.C.C. continues its policy of forcing the railroads to handle perishable produce at a loss." (304 F. Supp. at 808, App. 297a)

Plainly, the decision of the Reorganization Court is correct on the merits, as well as having regard to the procedural irregularities in which the Commission indulged. As Judge Weinfeld noted:

> "[The Commission's] findings as to non-operation of the yards made with respect to Penn Central, any terminal carrier, a new terminal carrier or the City of New York does not appear to be based upon substantial evidence. It is difficult to agree that an important rail service to industrial users would be terminated and the line dismantled. Nothing in the record supports the Commission's assumption that the properties would be stripped of their trackage and electricity, both highly desirable industrial features, and the former alone commanding about a 10% premium in Bronx realty values." (App. 442-43a).

In brief, then, the Commission's decision should not have been sustained by the majority of the Three Judge Court because it was supported by neither substantial nor proper evidence and because its critical finding was based upon matter dehors the record which was not, in the cir-

cumstances of the case, a proper matter of official notice. For this reason, that decision should be set aside. It is submitted, further, that the record evidence overwhelmingly establishes, as Judge Weinfeld and the Reorganization Court held, that the value of the Harlem River and Oak Point Yards is, at the minimum, the amount shown by Mr. McCann's higher appraisal, i.e., $22.65 million.

POINT V

The Commission's computation of the Discount to Present Value of Liquidation Receipts Which the Reorganization Court Rejected as Erroneous and the Three Judge Court Left for Decision by This Court, Is Not Supported by Substantial Evidence.

In their decisions disapproving the Commission's Inclusion Report, both courts directed the Commission to consider the effect of liquidation expenses in computing the present worth (as of the liquidation date) of the net liquidation proceeds which would be received over the six-year liquidation period. In its Inclusion Report, the Commission had discounted only certain gross receipts, using summary figures totalling $17,563,000 provided, during cross-examination, by the New Haven Trustees' witness, Mr. Gordon (Rec. 207c). (331 I.C.C. at 661, App. 19a).

At the remand hearings, both the bondholders and Penn Central introduced evidence on the proper amount of discount to present worth. Both Dr. Altman, who testified for the bondholders, and Mr. Hull, who testified for Penn Central, reached substantially identical results as to the amount of the discount attributable to expenses. Both witnesses also agreed in finding that the discount properly attributable to gross receipts was less than the figure used by the Commission. Mr. Hull's figure was approximately

$600,000 less than Mr. Gordon's figure (Rec. 363c, corrected at Rec. 442c). Dr. Altman's figure was approximately $2.5 million less than Mr. Gordon's figure (Rec. 369c, corrected at Rec. 429-32c).

The difference between their figures was attributable to differences as to the timing of receipts.*

In its Remand Report, the Commission accepted the essentially identical figures of Dr. Altman and Mr. Hull on the discount of liquidation expenses, but refused to recognize its error in computing the discount of gross liquidation receipts, saying in a footnote:

> "It is unnecessary to consider the differences between the parties' discounts of the proceeds, since we see no error in our prior opinion on this point." (334 I.C.C. at 40, n. 17, App. 127a)

In its decision of May 28, 1969 on the Remand Report, the Reorganization Court directed the Commission to file "a new formulation and computation of the discount for present value of the New Haven's liquidation proceeds, in accordance with generally recognized accounting principles and based upon the changes made in valuation items through and including those stated in the present opinion". Other parties were given leave to respond (304 F. Supp. at 810-11, App. 302a).

The Commission filed a response on June 10, 1969 in which it simply computed the changes in the discount figures developed by Mr. Gordon which were made neces-

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* Dr. Altman followed the timing evidence of the valuation witnesses at the original hearings, including in several instances the timing sequence used by Mr. Hull in his original testimony (Rec. 371-73c, 429-32c). For purposes of his remand testimony Mr. Hull made new estimates of the timing of certain receipts; he conceded that these estimates were at variance in a number of respects with the testimony of the valuation witnesses and in fact with his own earlier testimony. (Rec. 442-46c).

sary by the changes in valuation introduced by the intervening decisions of the Commission and the courts (Rec. 499-502c).

In analyzing this response, it was necessary to fully analyze Mr. Gordon's computations—a step which had not been necessary previously, except on specific points, because both Mr. Hull and Dr. Altman introduced complete studies which were independent of Mr. Gordon's approach. This analysis brought into focus the fact that it was impossible to arrive at a correct result, consistent with recognized accounting principles, by simply adjusting the Gordon figures because Mr. Gordon's discount figures were incomplete—they omitted certain receipts, notably $47,121,400 of equipment and investments which both Mr. Hull and Dr. Altman agreed had to be discounted, and included as receipts certain items, notably $8,177,633 for real estate and $17,591,589 gross salvage value of road property, which, as both Mr. Hull and Dr. Altman also agreed, should not be treated as receipts.* As a result of these gaps in Mr. Gordon's computations, the Commission's adjustments could not possibly be accomplished because they required a reduction in the discount for rolling stock where no discount had ever been taken by Mr. Gordon. Accordingly, in their response to the Commission's calculations (Rec. 502-10c), the bondholders attempted to reconcile

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* The $8,177,633 was not properly a receipt since this was the amount of market value which would be lost in the "distressed" sale, i.e., dispositions of real estate at reduced prices at the end of the liquidation period. Thus, the only "receipt" would be $3,000,000 on sales of property having a market value of $11,177,633. (Mr. Gordon and the Commission treated the $8,177,633 as an expense, which they did not discount.)

The problem with the $17,591,589 of road property was that if this were included as a receipt, it would have to be offset by an identical amount of expense. Both Mr. Hull and Dr. Altman simply eliminated that figure from both receipts and expenses.

Mr. Gordon's discount testimony with that of Dr. Altman in order to have a basis on which to take the Commission's adjustments into account. Contrary to the apparent view of the Three Judge Court majority, the bondholders' response offered no new evidence—the proper discount figures were already in evidence at the Remand hearings through their witness, Dr. Altman.

The Reorganization Court accepted the analysis of the bondholders, and adjusted the discount by $2.4 million, thereby in effect adopting the bondholders' evidence and adjusting it in the manner outlined in the Commission's June 10, 1969 letter, to take into account the various changes in valuation introduced by the intervening decisions, including that of the Reorganization Court.

The majority of the Three Judge Court accepted the adjustments proffered by the Commission in its Fifth Supplemental Report which, essentially, modified Mr. Gordon's figures to take into account changes in the valuation resulting from its decisions and the majority decision of the Three Judge Court. The majority noted, however, that:

> "The NH bondholders contend that, in addition to this sum, which they concede to be arithmetically correct for the items listed in the Commission's report, there should be a further reduction of $2,695,899. The basis for this was explained in a letter dated June 17, 1969, to the reorganization court and was adopted by it in an order dated July 28, 1969. We have not passed on the merits of this contention since we do not consider it to be appropriately before us on settlement of the decree. The difference in the treatment of this item by the two courts will be another matter for ultimate resolution by the Supreme Court." (App. 445a)

Judge Weinfeld apparently did not participate in this decision.

We have outlined the facts on this point in some detail because this question comes to this Court in a most peculiar stance. The Reorganization Court has found that the discount was overstated by $2,415,899; the Three Judge Court has found that it was overstated by $410,000, and has, in effect, left open for resolution by this Court whether that sum should be increased by approximately $2 million, without passing on the merits of that contention.

As we have noted above, the majority of the Three Judge Court misconceived the state of the record. The bondholders offered no new evidence on the discount issue, but merely submitted an alternative analysis to reach essentially the result shown by their evidence. We argued below—and we argue here—that it was error for the Commission to have failed to make this review once it had before it evidence from both parties in interest that its computation was wrong, and that, on the record, the Commission's finding as to the proper discount of gross liquidation receipts is not supported by substantial evidence.

The Reorganization Court carefully considered this question, and reached a decision which is fully supported by the record. In the circumstances, we submit, the Reorganization Court was entitled to make the necessary arithmetical computations and its decision should be sustained.

POINT VI

The Refusal of the Three Judge Court and the Reorganization Court to Award the New Haven "Going Concern" Value as an Element of Value in Addition to Liquidation Value Contravenes Applicable State Law and Therefore Unlawfully Deprives the New Haven of Value to Which It Is Entitled.

At the hearings before the Commission, the creditors' evidence demonstrated that in addition to the liquidation value of the physical assets and investments of the New Haven, there was a further intangible element of value, the value of the New Haven as an organized and functioning concern.* The Commission found in its Inclusion Report that the New Haven in fact had such a "going concern" value, to which it assigned a value of 10% of the creditors' figure of $55 million, or $5.5 million. But it treated this value as an alternative measure of the value of the assets to be conveyed. (331 I.C.C. at 684-85, 686, App. 42-43a, 44a).

Both Courts affirmed the Commission on this point (289 F. Supp. at 435 and 454-55, App. 239-40a, 347-49a). The Three Judge Court could find "no 'going concern value' in a deficit ridden railroad being liquidated as real estate or scrap . . ." (289 F. Supp. at 435, App. 347a). The Court recognized that the New York Court of Appeals had held, in *Port Authority Trans-Hudson Corp.* v. *Hudson Rapid Transit Tubes Corp.*, 20 N.Y.2d 457 (1967), *cert. denied*, 390

* For a discussion of the value of acquiring a going concern as opposed to initiating a brand new business, see *The City of Omaha* v. *Omaha Water Company*, 218 U.S. 180, 202 (1910); *Banner Milling Company* v. *New York*, 240 N.Y. 533, 544, 148 N.E. 668, 671-72, *cert. denied* 269 U.S. 582 (1925); *Kimball Laundry Co.* v. *United States*, 338 U.S. 1 (1948).

U.S. 1002 (1968) (the "*PATH* case"), that on a public taking of a transportation company for continued public transportation use, the owners of the condemned property were entitled to compensation over and above the reasonable scrap or liquidation value of the assets, regardless of the fact that as a private transportation company, it had no hope of net operating income.* Moreover, the Three Judge Court admitted that "[i]t is possible, perhaps even likely, that rather than suffer termination of the New Haven service, some of the states would condemn parts of NH's operating properties. . . ." (289 F. Supp. at 435, App. 347-48a).** Nevertheless, the Court distinguished the *PATH* case as dealing

> "with a unique situation where the larger part of the property being condemned, tunnels under the Hudson

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* The New York Court of Appeals had said in that case:

> "We are here concerned with a property which has a usefulness created by the owner himself through the expenditure of large sums of money and by the continued operation of the property for the very purpose for which the petitioner is acquiring the property. It is the owner who built the 'reservoir'—the Tube railway system in the present case. This owner has developed its property at a cost of millions of dollars and operated it for more than 50 years. It is admittedly of great usefulness in the daily transportation of thousands of commuters. A condemnor should not be permitted to tell him: 'It's only worth scrap or less'." (20 N.Y.2d at 468)

It awarded the condemnee the original cost of the tunnel less depreciation, as a measure of its value to the purchaser as a facility in being, as well as the scrap or market value of other assets.

** The Court also felt that the States would not have to use their condemnation power because the Commission had the power to condition a certificate of abandonment on the New Haven's agreement to sell its assets at scrap value for continued operation as a railroad (289 F. Supp. at 435, App. 348a). In fact, New York and Connecticut will probably purchase, or lease under long term conditions, these assets from Penn Central under an arrangement apparently already reached with Penn Central. See footnote, p. 59, *supra*.

River, had no value for any purpose save that for which they were being taken. . . ." (289 F. Supp. at 435, App. 348a).*

The Reorganization Court concurred with the Three Judge Court on similar grounds, saying "the concept of 'going concern value' is fictional as applied to the New Haven because it ignores the Railroad's long and continuous history of deficit operations. Indeed, as later noted herein, the New Haven's operations must soon terminate." (289 F. Supp. at 454-55, App. 239-40a).

Where the Commission and both courts erred, we submit, was in their assumption that an award of "going concern value" was inconsistent with the liquidation hypothesis of the valuation evidence. This, we submit, disregards the actual result of these proceedings, that the New Haven was kept in existence to be sold as a going concern.** Moreover, it is plainly contrary to the valuation standards of the condemnation law of New York State.

In the *PATH* case, *supra*, and in its more recent decision in *Matter of the City of New York (Fifth Avenue Coach Lines, Inc.)*, 22 N.Y.2d 613 (1968), the New York Court of Appeals has made it clear that where an ongoing enterprise is taken over in the public interest and the acquiring

* This was also true in large measure of the New Haven, especially with respect to its enormous investment in right of way. The New Haven liquidation study recognized that such assets as bridges, tunnels and embankments would be largely worthless in liquidation and would even create substantial removal costs, which are taken into account in the valuation evidence. (*cf.* Rec. 49-53c)

** We submit that there is an inherent contradiction between this view of the Commission's power to condition abandonment in order to preserve the ongoing operation and the claim that there is no value in the "going concern" features of such an enterprise. The contradiction is intensified by the Commission's analysis in this case, which penalizes the railroad on the theory that it must be kept going, and then awards nothing for going concern value.

entity continues to carry on the same business, using the same facilities, the "seller" must be compensated for the "scrap" or liquidation value of the physical assets transferred and, in addition, for the "going concern" aspects of its operation. In *PATH,* as we have noted, the New York Court of Appeals awarded compensation for the tunnels on the basis of original cost less depreciation. In the *Fifth Avenue Coach* case, the City of New York was required to pay the fair value of the bus company's franchises, although the franchises obviously had no value in the hands of the City, which could operate buses without any franchise. In an earlier decision in the *Fifth Avenue Coach* case, the Court of Appeals had been at some pains to identify the elements of "going concern" value which should be awarded upon such a taking. *Matter of the City of New York (Fifth Avenue Coach Lines),* 18 N.Y.2d 212 (1966). It specifically recognized as elements of "going concern" value, expenses for starting up operations, planning routes and schedules, acquiring and training personnel, and acquiring franchises. In all of these cases, the acquired enterprises had long histories of operating deficits and, at least in the *PATH* case, no contention was made (or could have been made) that there was any chance of operating the railroad system at a profit. The Court of Appeals did not regard this as inhibiting it from awarding a "going concern" value.

On the foregoing facts, it is submitted, the standard of fairness requires an award to the New Haven of going concern value. In addition to the standard of fairness, moreover, New York State law compels such an award. The Three Judge Court distinguished the *PATH* case as involving "compelling equities" because the operation involved there, a tunnel, was unique in that it could not be used for anything else. Whatever the relevancy of this factor, it is

no more compelling than those existing on the instant facts; the New Haven can only be used as a railroad.

It is submitted that the reviewing courts should have awarded the New Haven going concern value in addition to liquidation value, at least as to the New Haven's New York-based assets, which are considerable. In terms of real estate alone, over $37.6 million of the New Haven's total of $113.7 million worth of real estate is located in New York State (NHI-45, p. 29, filed in Document No. 119 in the Three Judge Court record). According to Mr. Gordon's estimate, $43.6 million of the New Haven's total liquidation value of $173.4 million for immovable assets were located in New York State (NHI-42, pp. 29-30, filed in Document No. 119 in the Three Judge Court record).

POINT VII

Penn Central Should Be Required to Assume all of the New Haven's Operating Losses for the Eleven Month Period Between the Effective Date of the Penn Central Merger and the Date of the New Haven's Inclusion.

In its Inclusion Report, the Commission developed a formula for computing the interim "operating losses" of the New Haven which, in its view, ought to be borne by Penn Central. It imposed a $5.5 million ceiling on the basis of evidence which suggested that the losses of the New Haven computed under the formula would not exceed $5.4 million in the year 1967; it then modified the formula to introduce a "sliding scale" whereby Penn Central would absorb 100% of the operating losses, determined under the Commission's formula, in the first year after its merger, 50% in the second year, 25% in the third year and nothing thereafter (331 I.C.C. at 718, App. 76a).*

* Thus, in the Inclusion Report, at least, the Commission clearly intended that Penn Central should absorb all of the New Haven's

The evidence at the inclusion hearings suggested that the Commission's estimate that the New Haven's annual losses would not exceed $5.5 million per year was unduly optimistic. As the Commission later conceded, subsequent events proved that it was too conservative (334 I.C.C. at 73, App. 160a).

A majority of the Three Judge Court voted to remand the interim loss question without fixing any standard for the sharing of losses (289 F. Supp. at 444-45, App. 365-68a). Judge Weinfeld dissented, saying:

> "Had that which should have been done, been done at the time of the merger, New Haven then would have become a unit of Penn Central, with the latter necessarily absorbing operating losses from the date of the merger; to require Penn Central to do so now imposes no unjust or onerous terms upon it. Penn Central, as the beneficiary of the merger, would be assuming a burden which was part of a single transaction—this, entirely apart from the creditors' claim that, constitutionally, they cannot be forced to bear the increased losses entailed by the continued operation of the New Haven pending inclusion." (289 F. Supp. at 449, App. 378a)

In its decision on the Inclusion Report, the Reorganization Court stated that the New Haven must cease opera-

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formula operating losses for at least the first year after the merger. (331 I.C.C. at 718-19, App. 76-77a) On the other hand, the Commission frankly avowed in the Inclusion Report that it was introducing the "sliding scale" formula in order to discourage prolonged litigation by the bondholders which might delay inclusion of the New Haven in Penn Central, although the Commission failed in its Inclusion Report to specify any period of time within which inclusion was to take place (331 I.C.C. at 718, App. 76a). The Three Judge Court condemned the "sliding scale" provision (289 F. Supp. at 444, App. 366-67a), which Justice Douglas had characterized as an *"in terrorem"* provision (*Penn Central Merger Cases*, 389 U.S. 486, at 557-58, dissenting opinion), and the Commission deleted it on remand (334 I.C.C. at 71-74, App. 158-61a).

tions on January 1, 1969, unless the Commission ordered inclusion by that date (289 F. Supp. at 459, App. 245a). It recognized the "cogency" of Judge Weinfeld's argument that the reasons for deferring inclusion of the New Haven after the date of the Penn Central merger were practical ones, largely for the benefit of Penn Central, and stated:

> "It may well be argued that the Commission and the Courts, including the Supreme Court, by approving the merger conditioned upon the inclusion of the New Haven, placed the responsibility on the Penn-Central for bearing the [interim] losses in the public interest, and thereby relieved the bondholders of that obligation. It will, however, rest within the judgment of the Commission on remand to decide whether all or only a portion of the losses of the New Haven should fairly be borne by the Penn-Central for the period February 1 to December 31, 1968." (289 F. Supp. at 461, App. 249a)

In its Remand Report, the Commission acknowledged that the New Haven's operating losses under its formula would be $8.2 million for 1968 (334 I.C.C. at 73, App. 160a).* Nevertheless, the Commission simply commuted its original loss-sharing formula to a lump sum payment by Penn-Central of $5 million (334 I.C.C. at 73-74, App. 160-61a).

While both the Reorganization Court (by implication) and the majority of the Three Judge Court have affirmed the Commission's interim "loss-sharing" determination (App. 428a),** their decision, we submit, is not support-

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* The evidence at the remand hearings suggests that its figure was still highly optimistic, and that the invasion of the bondholders' security, by cash losses and the accrual of prior claims, was as much as $15 million during the interim period. (*cf.* Rec. 326c)

** The majority stated that "this [decision] was well within the area confided to the Commission's judgment". (App. 428a).

able as fair or equitable in the circumstances of this case, involves an invasion of the constitutional rights of the bondholders and is, in our view, contrary to this Court's intent in approving the Penn Central merger on condition that the New Haven be included.

In his dissenting opinion on review of the Remand Report, Judge Weinfeld commented:

> "The Commission limits the loss that Penn Central is to bear to $5 million. Consistent with my view previously expressed, the entire interim losses should be borne by Penn Central. Its argument that it should not be charged with losses over which it has no control is stripped of much more of its force, since it had the opportunity, which it declined for reasons which even the Commission thought unpersuasive, to participate in a joint effort to achieve economies during the interim period." (App. 442a; Footnotes omitted)

A railroad cannot constitutionally be required to operate at a deficit with no foreseeable hopes for future profit. Requiring further losses under these circumstances constitutes a taking of property without just compensation. *Brooks-Scanlon Co.* v. *Railroad Commission*, 251 U.S. 396 (1920); *Railroad Commission* v. *Eastern Texas R.R.*, 264 U.S. 79, 85 (1924); *Bullock* v. *State of Florida ex rel. Railroad Commission*, 254 U.S. 513 (1921). Consequently, as both courts noted, continued operation of the New Haven could only be required for a reasonable period to accomplish inclusion (304 F. Supp. at 800, App. 283a; App. 408a).

Moreover, as the Reorganization Court observed in another context,

> "[T]he course of inclusion was followed; but because the merger and the reorganization proceedings stretched out far beyond what was originally forecast, the 'in-

> terim' became seven and a half years; and 'losses reasonably incident to working out the solution most consistent with the public interest' eroded the debtor's estate in excess of $60 million." (304 F. Supp. at 800, App. 283a)

The effect of the Commission's handling of the loss-sharing issue was to prolong this erosion.

In fact, the Commission rebuffed efforts to reduce the New Haven's losses. Although the Trustees' petitioned in 1965 for permission to abandon the New Haven's hopelessly unprofitable long haul passenger service, the Commission denied that application in April, 1966 in view of the fact that it was simultaneously approving the Penn Central merger, and requiring inclusion of all the New Haven's operations.

On July 11, 1967 the Reorganization Court asked the Commission to require that inclusion be effected simultaneously with the Penn Central merger, under a lease or other interim arrangement. The Commission in its Inclusion Report refused to order such a step, but instead adopted a loan arrangement (at the prime rate) and ordered Penn Central to absorb what we submit was a grossly inadequate share of the losses.

When, in its decision approving the Penn Central merger, this Court refused to require simultaneous inclusion of the New Haven as a condition precedent, it had before it the Commission's Inclusion Report which, at least in terms, may have appeared to provide for full absorption by Penn Central of the New Haven operating losses during at least a reasonable period within which inclusion could take place. In fact, the formula devised by the Commission in its Inclusion Report, and taken over into the Commission's Remand Report, has the effect of requiring the New

Haven to absorb at least 33% of the losses allowed for in the Commission's formula during the first year after the merger, and, based upon the evidence of the record, may have required the bondholders to bear over 65% of the New Haven's actual losses for that period.

Such a result, we submit, is neither consistent with the intention of this Court in approving the Penn Central merger nor fair and equitable to the New Haven. By its merger, Penn Central has attained operating savings which, as Judge Weinfeld noted in his concurring opinion on the Inclusion Report, have a capitalized value of about $900 million (289 F. Supp. at 449, App. 358a).

We respectfully submit that Judge Weinfeld's position is the correct one and one which fairness and equity, under Section 5(2) of the Interstate Commerce Act and Section 77 of the Bankruptcy Act, as well as the decision of this Court approving the Penn Central merger, require. The New Haven was kept alive—and the bondholders were forced to absorb losses of over $60 million—in order that, in the public interest, its operations could be included in Penn Central. The only reason advanced for delaying inclusion beyond the date of the Penn Central merger was the convenience of Penn Central. Under these circumstances, we submit, there was no warrant to impose upon the New Haven estate any further burden for losses beyond the merger date.

CONCLUSION

By reason of the foregoing, we respectfully submit that the orders of the Three Judge Court and the Reorganization Court should be reversed and remanded for modification in accordance with the objections set forth in the respective appeals and petitions of Manufacturers Hanover Trust Company, as Trustee, and the Bondholders Committee, and that the Three Judge Court and the Reorganization Court should be directed to remand the Fourth Supplemental Report and Order and the Fifth Supplemental Report and Order of the Commission with instructions to the Commission to modify its Reports and Orders in accordance with the directions of this Court.

Respectfully submitted,

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